

# Chapter 2

## Issues

2.1 The Government Investment Funds Amendment (Ethical Investments) Bill 2011 seeks to constrain the investments of government investment funds, namely those created by the *Future Fund Act 2006* and the *Nation-building Funds Act 2008*, to those investments which are consistent with socially responsible investment practices. The Bill will proscribe investments by the funds in companies involved in the manufacture of tobacco, cluster munitions, nuclear arms and other entities to be proscribed under Ethical Investment Guidelines.<sup>1</sup>

2.2 As outlined in chapter 1, a range of approaches to Responsible Investment have been explored internationally and in Australia. While there are several Sovereign Wealth Funds (SWFs) with explicit Responsible Investment policies, legislated arrangements with the breadth proposed in the Bill are rare.

2.3 The committee has considered a range of issues arising from the Bill including the appropriateness of legislation on ethics; whether the proposed delegation and breadth of powers is appropriate; the impact on the independence of the Future Fund Board of Guardians; the costs of implementation if the Bill were to be enacted; whether the Bill reflects best practice for Responsible Investment; and overseas practice.

### The need for the Bill

2.4 There were comments in evidence which questioned the need for the Bill particularly in relation to the appropriateness of legislating for ethical investments. The Department of Finance and Deregulation (the department) and the Future Fund also pointed to the Future Fund's approach to ESG issues.

### *Appropriateness of legislating on ethics*

2.5 The committee is concerned about the ethics focus of the Bill and notes that concerns regarding legislating on ethics were raised about a similar draft Bill in the ACT.<sup>2</sup> Evidence was also received that rather than 'ethical investment', the Bill should refer to 'Responsible Investment'. Mr Tomohiro Matsuoka, for example, noted developments in the investment industry and supported this change:

Historically, investment methods which incorporate non-financial factors, such as, social, environmental and governance (so called ESG), or methods

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1 Explanatory Memorandum, p. 2.

2 ACT Legislative Assembly Standing Committee on Public Accounts, *Inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010*, February 2011, p. 8.

which apply exclusion criteria for certain types of businesses (such as tobacco, alcohol, or pornography) are referred as socially responsible investment (SRI) or ethical investment (EI). However, in recent years, investment communities are more prone to adopt the term, responsible investment, instead of socially responsible investment or ethical investment.<sup>3</sup>

2.6 Oxfam also supported a change of terminology in the Bill, noting that Responsible Investment tends to use a broader range of internationally recognised tools for applying principles to investment screening as compared to ethical or socially Responsible Investment. Oxfam also indicated to the committee that:

Responsible Investment has been codified in international norms, such as the United Nations Principles for Responsible Investment, which provides actors seeking to introduce Responsible Investment with certainty and a greater level of non-partisan transparency in its application.<sup>4</sup>

2.7 On the other hand, the Responsible Investment Association of Australasia (RIAA) submitted to the committee that the 'Bill in its current form will require government investment funds to exclude investment in companies on values-based grounds—the use of the term "ethical investment" is appropriate in this context'.<sup>5</sup> However, RIAA went on to note that:

By focussing solely on the avoidance of activities judged to be not ethical, the Bill as it is framed misses an opportunity to promote industry best practice in the form of ESG integration.<sup>6</sup>

2.8 The department submitted that it should be noted that the term ESG, as defined by many mainstream investors, differs from 'ethical investment'. Ethical investment decisions are often motivated by the institution's beliefs or values, with a focus on excluding certain types of investments, rather than seeking to improve investment decision-making.<sup>7</sup> The department also noted that:

The Bill states that the Ethical Investment Guidelines may make provisions for 'socially responsible ethical investment practices'. Finance considers that there is considerable ambiguity in the meaning of this term, and of what standard would determine the ethics to be applied.<sup>8</sup>

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3 Mr Tomohiro Matsuoka, *Submission 4*, p. 1.

4 Oxfam, *Submission 10*, p. 5.

5 Responsible Investment Association of Australasia, *Submission 11*, p. 2.

6 Responsible Investment Association of Australasia, *Submission 11*, p. 4.

7 Department of Finance and Deregulation, *Submission 8*, pp 3–4.

8 Department of Finance and Deregulation, *Submission 8*, p. 9.

### *The Future Fund's investment approach*

2.9 The committee heard a range of views on whether the Bill represented the best approach to Responsible Investment. RIAA suggested to the committee that there is a range of other approaches to Responsible Investment.<sup>9</sup> Oxfam held a similar view and informed the committee that:

...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.<sup>10</sup>

2.10 In response to evidence about Responsible Investment, the department stated that the investment mandate for the Future Fund already requires the Board to have regard to international best practice for institutional investment in determining its approach to corporate governance principles, including in relation to its voting policy.<sup>11</sup>

2.11 The Future Fund provided an outline of its approach to ESG issues and portfolio exclusions and stated that it has developed a clear investment program, designed to pursue its statutory obligations, that incorporates its Ownership Rights and ESG Risk Management Policy. The Future Fund also pointed to improvements in its ESG policy.<sup>12</sup> These include, the appointment, in July 2009, of an experienced program manager to lead its ESG risk management.<sup>13</sup> In addition, the Future Fund has established a governance committee that will oversee the internal governance of the fund and will focus on environmental, social and governance issues.<sup>14</sup> The Future Fund also stated that it 'takes seriously its obligations under the legislation and investment mandates to consider international best practice in all aspects of its investment program'.<sup>15</sup>

2.12 In relation specifically to exclusions, the Future Fund's statement of investment policies already covers exclusion of investments, with investment being excluded for any entity or relevant funding activity that is unlawful. There may be

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9 Responsible Investment Association of Australasia, *Submission 11*, p. 3.

10 Oxfam, *Submission 10*, p. 14.

11 Department of Finance and Deregulation, *Submission 8*, p. 3.

12 Future Fund, *Submission 12*, p. 6.

13 Ethical Investor, *Future Fund makes key ESG, Governance appointment*, 8 July 2009, [http://www.ethicalinvestor.com.au/index.php?option=com\\_content&task=view&id=3121&Itemid=402](http://www.ethicalinvestor.com.au/index.php?option=com_content&task=view&id=3121&Itemid=402), (accessed 5 July 2012); see also Mr Mark Burgess, Managing Director, Future Fund Management Agency, *Committee Hansard*, 8 August 2012, p. 25.

14 Mr Mark Burgess, Managing Director, Future Fund Management Agency, *Committee Hansard*, 8 August 2012, p. 34; see also Department of Finance and Deregulation, *Submission 8*, p. 6.

15 Future Fund, *Submission 12*, p. 10.

other circumstances in which a lawful activity may be excluded by the Future Fund, such as entities contravening treaties or international conventions ratified by Australia.<sup>16</sup> The Future Fund also told the committee that:

...engagement with companies is now considered world's best practice, not exclusions, on at least at the first level and that the board is committed to that engagement with fiduciaries to ensure that best practice behaviour fits the standards of the board.<sup>17</sup>

2.13 The Future Fund has a three stage process for assessing investments that:

...firstly, is the investment or funding legal?...Secondly, we recognise the nature of our organisation and the fact that Australia as a country has state party obligations to certain treaties...then we turn to the third element of our policy...What are the economic activities of the company and do those economic activities contravene the nature of the international conventions or treaties ratified by Australia?' We apply that test to all companies and we believe that all our companies satisfy those three tests. If they do not, they are not investable.<sup>18</sup>

2.14 In relation to the Future Fund's approach to ESG matters, RIAA acknowledged that the Future Fund has shown leadership in the steps it has taken to date. While the RIAA provided recommendations in a number of areas where the Future Fund could better integrate the United Nations' Principles for Responsible Investment with its ESG policy, the RIAA did not consider that the Bill was seeking the same outcome. The RIAA commented that 'the difficulty with linking the PRI [Principles for Responsible Investment] to the Bill as it is written is that they are seeking to achieve very different things'.<sup>19</sup>

## **Change to the independence of the Future Fund**

2.15 Of significant concern to the Future Fund and the department was the impact of the Bill on the independence of the Future Fund and the introduction of uncertainty through the influence of the responsible Ministers in decision-making. The provisions relating to the introduction of responsible Ministers in decision-making were also noted by the Senate Scrutiny of Bills Committee which considered that the provisions delegated legislative powers inappropriately and provided insufficient Parliamentary scrutiny.<sup>20</sup>

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16 Department of Finance and Deregulation, *Submission 8*, p. 6.

17 Mr Mark Burgess, General Manager, Future Fund Management Agency, *Estimates Hansard*, 14 February 2012, p. F&PA 77.

18 Mr Gordon Hagart, Head of ESG Management Risk, Future Fund Management Agency, *Committee Hansard*, 8 August 2012, pp 32–33.

19 Mr Duncan Paterson, Chair, Responsible Investment Association Australasia, *Committee Hansard*, 8 August 2012, p. 22.

20 Senate Scrutiny of Bills Committee, *Second report for 2012*, 29 February 2012, p. 82.

2.16 The sponsoring senators responded to the Scrutiny of Bills Committee, suggesting that the Ethical Investment Guidelines could be considered to be similar to and follow the precedence of the existing Investment Mandate, which is provided for, but not detailed in legislation. While they shared concerns around excessive delegation of powers to the Executive, they suggested that the Government has no incentive to make guidelines that are overly restrictive and adversely affect the returns of the Fund.<sup>21</sup>

2.17 However, the department commented that the Bill could provide a quite wide-ranging framework for influence by responsible Ministers in decision-making and thus potentially 'create a range of excluded types of investment and set quite a broad set of ethical guidelines'. This would make a significant change to the purpose of the Future Fund: the Fund at present focusses on 'strengthening the Commonwealth's long-term financial position, and it would change that to use the Future Fund to try to achieve other policy objectives'.<sup>22</sup>

2.18 The department further informed the committee that:

There are significant considerations [that] flow from that, which we are suggesting committee may wish to consider. For example, it creates ambiguity around the role of the board and the potential for conflicts in purpose when making investment decisions. We have expressed the view that it would constrain the ability the board to deliver on its long-term investment strategy, and that has implications for costs, implications for future returns and implications for the government's future position, which is what this fund was set up for.<sup>23</sup>

2.19 The department outlined the existing 'arm's-length arrangement' in which the responsible Ministers are not involved in investment matters beyond the broad parameters established by the Future Fund Act and the investment mandate. The department argued that the Bill would alter that arrangement.<sup>24</sup> The Future Fund informed the committee that:

There are aspects of this structure which we have not seen anywhere else. It introduces a structure that is different to the fund's current standing, its independence and in fact its world standing as a well-structured governance structure.<sup>25</sup>

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21 Senate Scrutiny of Bills Committee, *Second report for 2012*, 29 February 2012, p. 83.

22 Mr Alan Greenslade, First Assistant Secretary, Funds and Superannuation Division, Department of Finance and Deregulation, *Committee Hansard*, 8 August 2012, p. 27.

23 Mr Alan Greenslade, First Assistant Secretary, Funds and Superannuation Division, Department of Finance and Deregulation, *Committee Hansard*, 8 August 2012, p. 27.

24 Department of Finance and Deregulation, *Submission 8*, p. 10.

25 Mr Mark Burgess, Managing Director, Future Fund Management Agency, *Committee Hansard*, 8 August 2012, p. 35.

2.20 The independence of the Board in its investment decision-making is reinforced by section 18A of the Future Fund Act, which prevents the responsible Ministers from giving directions that require the Board to invest in particular assets, businesses or activities.<sup>26</sup>

2.21 The department indicated the Bill would introduce a significant change in the current decision-making arrangements:

To date, the policy of successive governments has been to ensure that investment decisions are independent of government, and that view is reflected in the Future Fund Act...The present arrangements have provided for a stable, long-term investment mandate from government. The bill would create a second set of ministerial directions with different policy objectives...Those policy objectives could change over time—they could change with different governments and so on—so it would create a shorter-term as opposed to a longer-term horizon on some of those objectives.<sup>27</sup>

2.22 The department went on to note that the Bill does not address where the ethical guidelines would sit in the hierarchy of priorities for the Board, with the Board 'likely to be faced with conflicting demands when making investments'.<sup>28</sup> The Future Fund had similar concerns:

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.<sup>29</sup>

2.23 The Future Fund also informed the committee that, in its view, it would not be able to assess how it would practically implement the provisions of the Bill in the absence of specifically tailored and defined arrangements and that the Bill raises clear implications for the independence of the Fund:

The provisions relating to 'socially responsible ethical investment practices' are unclear.

...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

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26 Department of Finance and Deregulation, *Submission 8*, p. 3.

27 Mr Alan Greenslade, First Assistant Secretary, Funds and Superannuation Division, Department of Finance and Deregulation, *Committee Hansard*, 8 August 2012, pp 26–27; see also Mr Alan Greenslade, First Assistant Secretary, Funds and Superannuation Division, Department of Finance and Deregulation, *Committee Hansard*, 8 August 2012, p. 30.

28 Department of Finance and Deregulation, *Submission 8*, p. 7.

29 Future Fund, *Submission 12*, p. 8.

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elements of the investment program at a detailed level and in a manner which is currently not the case.<sup>30</sup>

2.24 In addition, the committee was advised that the reputation for independence of the Future Fund Board of Guardians was a key element of the Future Fund's ability to operate commercially and any changes that would undermine this reputation had the potential for adverse outcomes. The Future Fund stated that:

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.<sup>31</sup>

2.25 At the committee's hearing, this point was further canvassed. Both the department and the Future Fund emphasised the need for stability and clarity in relation to investments. It was noted that:

It would have an impact on the independence of the fund and on the operation of the fund. Any uncertainty or lack of clarity around the mandate, or even expected future lack of clarity around the mandate, can certainly affect the fund, particularly as it invests on a long-term basis at best practice level while working with global partners in that investment.<sup>32</sup>

2.26 The Future Fund provided an example of infrastructure investment:

We will be partnering with others as we often do. These are 10-year investments and investments which I think are to the benefit of Australia and certainly to the fund. If there were some lack of clarity which raised a concern that, on some future occasion, our ability to invest with them may be compromised—that we may have to sell for some reason or management of these investments may be taken out of the board's hands—that could affect our ability to invest.<sup>33</sup>

2.27 The Future Fund concluded:

One of the aspects that I think is to the credit of the fund is that, as our mandate currently stands and as our governance framework currently stands, we are partner of choice amongst the best investors globally. I think that does reflect very well on our current structure.<sup>34</sup>

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30 Future Fund, *Submission 12*, pp 7–8.

31 Future Fund, *Submission 12*, p. 10.

32 Mr Mark Burgess, Managing Director, Future Fund Management Agency, *Committee Hansard*, 8 August 2012, p. 32.

33 Mr Mark Burgess, Managing Director, Future Fund Management Agency, *Committee Hansard*, 8 August 2012, p. 34.

34 Mr Mark Burgess, Managing Director, Future Fund Management Agency, *Committee Hansard*, 8 August 2012, p. 35.

## Costs of implementation and impact on returns

2.28 Another concern brought to the committee's attention is the financial impact of the Bill. The committee received evidence relating to on-going costs arising from closer monitoring of the activities that entities are involved in and the impacts on the returns to the Future Fund and the Nation-building Funds.

### *On-going costs*

2.29 The department indicated that, if the provisions of the Bill were implemented, there were likely to be resourcing implications as additional monitoring and reporting arrangements would be required. In relation to the Future Fund, the department stated that evidence from funds with guidelines such as those proposed in the Bill can be resource intensive.<sup>35</sup> In addition, there would be a significant role for the responsible Ministers in monitoring and reporting which would require departmental support.<sup>36</sup> These costs would increase 'where the parameters for prohibitions and for "socially responsible ethical investment practices" are unclear or hard to define'.<sup>37</sup>

2.30 The department also informed the committee that costs arising from the need to undertake additional analysis of listed companies to determine if they were involved in prohibited activities would affect the returns of the Future Fund. The department indicated that while this could either be done by developing further in-house capability or by contracting the expertise, but both options would carry significant costs, which would be taken out of the returns.<sup>38</sup>

2.31 RIAA also provided evidence on costs and commented that cost 'depends entirely on the nature of the sorts of steps that the fund wants to take'. RIAA went on to state:

So I do not think that cost, specifically in terms of the transparency elements of it and the methodology element of it, needs to be a prohibitive factor; but, having said that, other areas of cost do arise. For instance, if one were to impose a set of ethical views on a pooled mandate that one were investing in then, depending on market conditions, it may be the case that the fund manager would choose to levy a higher fee on you. I think that is a problem that is faced by large institutional investors who invest through broad mandates; they find that they pay higher fees. That is a much, much bigger cost concern for an asset owner.<sup>39</sup>

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35 Department of Finance and Deregulation, *Submission 8*, p. 9.

36 Department of Finance and Deregulation, *Submission 8*, p. 9.

37 Future Fund, *Submission 12*, p. 10.

38 Department of Finance and Deregulation, *Submission 8*, p. 9.

39 Mr Duncan Paterson, Chair, Responsible Investment Association Australasia, *Committee Hansard*, 8 August 2012, pp 21–22.



## *Impact on returns*

2.32 In addition to the impact of increased on-going costs, the committee heard conflicting evidence on whether Responsible Investment had a direct impact on returns. RIAA, for example, noted that a common criticism of ethical investment was that by restricting the 'investable universe' of a fund, that investment returns are restricted. RIAA went on to comment:

History has shown that there is much more complexity in the process than that. Ethical investment funds do tend to be competitive in terms of financial returns over time. It is not the case that by adopting an ethical investment policy you are necessarily going to restrict your portfolio to the extent where you are going to have a negative impact on returns.<sup>40</sup>

2.33 Oxfam also commented on returns and stated:

Importantly, the evidence demonstrates that in comparison to conventional investment techniques responsible investment offers competitive returns in the short term and often better returns in the longer term. These are key considerations for the funds targeted by this bill, focused as they are on strengthening the Australian government's long-term financial position by making provision for unfunded Commonwealth superannuation liabilities.<sup>41</sup>

2.34 The Future Fund's investment in companies that may be involved with nuclear weapons and tobacco stocks represents less than half of one per cent of the Fund's total value of \$77 billion:<sup>42</sup> \$179 million invested in 22 companies that may be involved with nuclear weapons;<sup>43</sup> and \$225 million in tobacco stocks.<sup>44</sup> While the impact on returns from divesting investments in tobacco and nuclear weapons, may not be material, the provisions of the Bill have more significant implications for investment returns. In particular, pursuant to proposed paragraph 20A(2)(b), the Future Fund Ethical Investment Guidelines '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'.<sup>45</sup> This may have substantial implications for investment. The RIAA commented:

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40 Mr Duncan Paterson, Chair, Responsible Investment Association Australasia, *Committee Hansard*, 8 August 2012, p. 21.

41 Mr James Ensor, Policy Director, Oxfam Australia, *Committee Hansard*, 8 August 2012, p. 1.

42 Future Fund, main webpage, <http://www.futurefund.gov.au/> (accessed 23 July 2012).

43 Future Fund, publicly available information released after an FOI disclosure, *The ICANW sought documents on the Future Fund's equity holdings in certain companies*, 13 May 2011, [http://www.futurefund.gov.au/\\_data/assets/pdf\\_file/0018/4581/FOI\\_Disclosure\\_Log\\_doc\\_A174749.pdf](http://www.futurefund.gov.au/_data/assets/pdf_file/0018/4581/FOI_Disclosure_Log_doc_A174749.pdf), (accessed 5 July 2012).

44 Additional Estimates 2011–12, Future Fund, Answer to Question on Notice, No. F65.

45 Government Investment Funds Amendment (Ethical Investments) Bill 2011, paragraph 20A(2)(b).

The bill as proposed does include reference to a broader range of criteria, however...If one were to put together a policy that incorporated negative screening across that broad range of areas and you started to screen out companies that were, for instance, judged to be doing environmental harm or having high impact in terms of climate change, it is quite likely that you would start to make fairly significant dents in your investable universe and it is quite likely that, unless you were very actively managing a specific portfolio for those risks, you would be making it quite difficult to manage the funds.<sup>46</sup>

2.35 In addition to the above, the department submitted that if the Bill were implemented it may be necessary to revisit elements of the investment mandate, including the benchmark return. In particular, there would likely be a negative impact on risk and return if the constraints in investment opportunities resulting from the Bill change the investment strategies to a significant degree.<sup>47</sup> The Future Fund had similar concerns:

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.<sup>48</sup>

2.36 The committee was also informed that the Bill may be ambiguous regarding what would constitute an 'interest'. The concept of interest is not defined in the Bill nor in the Future Fund Act or the Nation-building Funds Act. The department went on to note that:

Depending on the corporate structure of a manufacturer or producer, or the particular type of financial asset acquired, an investment by the Board might not involve the acquisition of a prohibited financial asset within the terms of the legislation. Conversely, if a broad definition of an 'interest' was adopted, this could apply not only to the Future Fund's direct investments, but to a range of other investment arrangements such as co-investments, joint ventures, fund-of-fund structures and pooled investments.<sup>49</sup>

## **Investment practices in other jurisdictions**

2.37 The committee examined developments in other jurisdictions in relation to exclusions and restrictions on investments. In terms of particular industry sector exclusions, the Australian Lung Foundation, the Australian Council on Smoking and Health and the Royal Australasian College of Physicians noted divestment of tobacco

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46 Mr Duncan Paterson, Chair, Responsible Investment Association Australasia, *Committee Hansard*, 8 August 2012, p. 21.

47 Department of Finance and Deregulation, *Submission 8*, p. 8.

48 Future Fund, *Submission 12*, p. 10.

49 Department of Finance and Deregulation, *Submission 8*, pp 8–9.

by some funds.<sup>50</sup> Submitters including Quit Victoria, Action on Smoking and Health Australia and the Heart Foundation also noted that the Framework Convention on Tobacco Control discourages investment in the tobacco industry.<sup>51</sup> ICAN also informed the committee that:

Both the Norwegian Government Pension Fund and the New Zealand Superannuation Fund have divested from companies involved in nuclear weapons production and simulated nuclear testing, and the Future Fund itself has divested from the manufacturers of cluster munitions and land mines.<sup>52</sup>

2.38 Oxfam noted that some SWFs, such as those in Sweden, France and Norway, are subject to a legislative direction to invest responsibly.<sup>53</sup>

2.39 The Future Fund and the department noted that several SWFs or pension funds have Responsible Investment policies that include exclusions. Exclusions for cluster bombs and anti-personnel mines appear to be fairly common, while exclusions based on tobacco and nuclear weapons are less common.<sup>54</sup> The Future Fund told the committee that, in its view, it should not be assumed that the use of exclusions is a standard practice for institutional investors globally. In addition, the Future Fund stated that in most cases consideration of exclusions is done at the Board level, with Norway an exception. The Fund indicated that it was not aware of any arrangements that allocate decisions on prohibition solely to a minister.<sup>55</sup>

2.40 The department also responded to the evidence relating to the Norwegian model. It noted key differences with the Norwegian model which may not make it appropriate for the Future Fund to implement:

The Norwegian model requires additional resources dedicated to screening and implementing the exclusion policy. This model requires a high level of involvement by the Norwegian Government in the Fund's investment decisions. It is very different from the Australian approach with the Future Fund, where the Board of Guardians is a separate legal entity to the

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50 Australian Lung Foundation, *Submission 7*, Attachment 1, p. 1; Australian Council on Smoking and Health, *Submission 1*, p. 2; The Royal Australasian College of Physicians, *Submission 9*, p. 3.

51 Quit Victoria, *Submission 2*, p. 1; Action on Smoking and Health Australia, *Submission 3*, p. 1; Health Foundation, *Submission 5*, p. 2; see also The Royal Australasian College of Physicians, *Submission 9*, p. 1, 3.

52 International Campaign to Abolish Nuclear Weapons (Australia), *Submission 6*, p. 2.

53 Oxfam, *Submission 10*, p. 12.

54 Future Fund, *Submission 12*, pp 11–12; Department of Finance and Deregulation, *Submission 8*, pp 4–5.

55 Future Fund, *Submission 12*, p. 11.

Commonwealth and makes investment decisions independent of the Government.<sup>56</sup>

2.41 In addition, the Future Fund commented that most major funds have clearly defined roles and independence from government, for example, the Canadian Pension Plan.<sup>57</sup>

2.42 In contrast, the committee notes that the New Zealand Parliament has considered legislation on ethical investment. The Ethical Investment (Crown Financial Institutions) Bill, introduced into the New Zealand Parliament sought to amend Acts, including the *New Zealand Superannuation and Retirement Income Act 2001*, to provide for a legislated ethical investment framework over and above the existing policy framework. The Bill was defeated on 4 August 2010, with the key reasons being uncertainty of terminology in the Bill and that responsible practices were already established within the New Zealand Government investment institutions by way of operational, not legislated, policies and governance structures.<sup>58</sup>

2.43 A further example occurred recently in the ACT. The exposure draft of a similar Bill, the Financial Management (Ethical Investment) Legislation Amendment Bill 2010 (ACT Bill) was referred to the Standing Committee on Public Accounts (SCPA) for inquiry.<sup>59</sup> The range of proscribed activities proposed by the Bill was seen as being broad and the ACT Government estimated that 'approximately one third of the Australian equity market index (S&P/ASX300 index) would be excluded from investment' if the Bill was enacted.<sup>60</sup> The ACT Government did not support the exposure draft of the ACT Bill.

2.44 The SCPA recommended, in December 2011, that the ACT Bill not be tabled in, and not be supported by, the ACT Legislative Assembly.<sup>61</sup> A revised Bill was presented to the ACT Legislative Assembly on 9 May 2012 and remains before the

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56 Department of Finance and Deregulation, *Submission 8*, p. 5; see also Mr Mark Burgess, Managing Director, Future Fund Management Agency, *Committee Hansard*, 8 August 2012, p. 29.

57 Mr Mark Burgess, Managing Director, Future Fund Management Agency, *Committee Hansard*, 8 August 2012, p. 35.

58 ACT Government, *Submission to the ACT Legislative Assembly Standing Committee on Public Accounts, Inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010*, p. 23.

59 ACT Legislative Assembly, Minutes of Proceedings No. 76, Wednesday 22 September 2010, pp 891–892.

60 ACT Government, *Submission to the ACT Legislative Assembly Standing Committee on Public Accounts, Inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010*, p. 27.

61 ACT Legislative Assembly, Standing Committee on Public Accounts, *Inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010*, December 2011, p. 9.

assembly. The revised Bill focusses more on Responsible Investment than ethical investment and has a narrower scope, with proposed exclusions on tobacco, arms or armaments, cosmetics that are tested on animals, and the manufacture or sale of products produced using labour in breach of international labour obligations.<sup>62</sup>

## Conclusion

2.45 The Future Fund was established with the aim of strengthening the Commonwealth's long-term financial position by making provision for unfunded Commonwealth superannuation liabilities. The Government Investment Funds Amendment (Ethical Investments) Bill 2011 seeks to legislate for ethical investment and in so doing proposes to use the Future Fund to support other policies.

2.46 While such an aim may be welcomed by some, the provisions of the Bill allow for responsible Ministers to influence the investment decision-making processes of the Future Fund Board of Guardians. The committee does not support this approach as it would undermine the independence of the Future Fund and change the structure of the Fund from that originally established. This change would introduce ambiguity, instability and lack of clarity to investment decision-making. At the present time, the Future Fund has a single clear objective and hierarchy of priorities. Implementing the Bill could mean conflicting priorities which may impact on risk and return.

2.47 The Bill is likely to have a negative impact on risk and return if investment strategies were changed to a significant degree because of constraints to investment opportunities. In addition, there would be higher costs for monitoring and reporting which would have adverse effects on the Funds' rate of return. The committee notes that both the Future Fund and department commented that it may be necessary to revisit elements of the investment mandate, including the benchmark return, if the Bill was implemented.

2.48 The committee acknowledges the world-wide development of Responsible Investment practices. In relation to these, the Future Fund has comprehensive ESG policies which are regularly reviewed and enhanced. It is required to have regard for international best practice and is fully compliant with the Santiago principles which establish best practice for sovereign wealth funds. The Future Fund also must comply with the requirements of the *Financial Management and Accountability Act 1997* and appear before this committee at Senate estimates. In addition, the staff of the Future Fund Management Agency must operate in accordance with the Australian Public Service values and code of conduct. The committee considers that these mechanisms, taken together, ensure that the Future Fund acts in a responsible and appropriate manner.

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62 Explanatory statement, ACT Financial Management (Investment) Legislation Amendments Bill 2012, p. 2.

2.49 Having considered the evidence before it, the committee concludes that there are significant adverse consequences for the Future Fund if the Government Investment Funds Amendment (Ethical Investments) Bill 2011 is enacted. Further, there are a range of mechanisms already in place which ensure that the Future Fund adheres to best practice and acts responsibly. Therefore, the committee does not support the Bill.

### **Recommendation 1**

**2.50 The committee recommends that the Government Investment Funds Amendment (Ethical Investments) Bill 2011 not be passed.**

**Senator Helen Polley**  
**Chair**