

Dissenting Report

Australian Greens

1.1 The *Government Investment Funds Amendment (Ethical Investments) Bill 2011* is being introduced in order 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.¹

1.2 The Bill will require the creation of Ethical Investment Guidelines which proscribe investments by the Future Fund and Nation-building Funds in companies involved in the manufacture of tobacco, cluster munitions, nuclear arms and other entities to be proscribed under Ethical Investment Guidelines.²

1.3 The Bill seeks to make it possible to address the ramifications of an investment beyond the financial returns, such as the impacts on the environment, the rights of those employed by the various enterprises, impacts on human health or potential effect on peace and stability. The Greens consider that Australia's sovereign wealth fund should endorse international practice on responsible/ethical investment. Many examples of responsible and ethical investment guidelines already exist around the world, including superannuation funds and sovereign wealth funds such as the Norwegian government pension fund.

Need for change in investment practices

1.4 The committee majority report does not support the bill. The Greens find this quite perplexing given the significant harms that tobacco, nuclear arms and cluster munitions cause.

Tobacco

1.5 During the committee's inquiry those who have seen the harm caused by tobacco voiced their support for the Bill. Australian Council on Smoking and Health (ACOSH) and Action on Smoking and Health (ASH) submitted that tobacco is the leading cause of preventable death and disease in Australia.³

...tobacco kills more than 15,000 Australians every year and costs our economy more than \$30 billion annually. Cigarettes, when used precisely as intended, kill one of every two long term users.⁴

1 Explanatory Memorandum, p. 1.

2 Explanatory Memorandum, p. 1.

3 Australian Council on Smoking and Health, *Submission 1*, p. 1; Action on Smoking and Health Australia, *Submission 3*, p. 1.

4 Australian Council on Smoking and Health, *Submission 1*, p. 1.

1.6 Those views were echoed by the National Heart Foundation and the Australian Lung Foundation which also submitted that tobacco use, and second-hand smoke exposure, contribute to 10 to 13 per cent of all cardiovascular deaths.⁵

1.7 Witnesses found it ironic that on the one hand the Government is seeking to reduce the adverse health impacts of smoking through steps such as plain packaging legislation, which on the other the Future Fund's investments increase in value as more and more people become addicted to cigarettes. ACOSH, for example, stated:

The irony of these investments is that they increase in value as more and more people become addicted to cigarettes – causing an inherent conflict of interest in simultaneously investing in the tobacco industry to make money from this lethal industry, and actively leading the way world-wide to reduce smoking.⁶

1.8 ASH asserted that 'it is inappropriate for Governments to be investing in an industry that is both lethal and working actively to undermine, oppose and subvert government health policies'.⁷ Other submitters including the Australian Lung Foundation and Quit Victoria raised concerns regarding the Future Fund investments in companies that are challenging policies and law designed to reduce the harm from tobacco.⁸ Quit Victoria submitted:

...while Australia is expending considerable sums of money to defend plain packaging laws designed to reduce tobacco consumption, we are also investing hundreds of millions of dollars in tobacco companies who are fighting to have these laws overturned.⁹

1.9 The Royal Australasian College of Physicians (RACP) submitted that 'tobacco policy must be considered as a system of actions aimed at denormalising tobacco use, where any number of positive actions can be undermined by smaller negative actions' and that the Government's investments via the Future Fund undermine the denormalisation of tobacco use at work in other policy instruments.¹⁰ RACP commented on the international impacts of tobacco:

Tobacco companies key growth markets are developing countries. The World Bank estimates that 84 per cent of the world's smokers live in developing countries and that 80 per cent of tobacco deaths by 2025 will be in developing countries.¹¹

5 National Heart Foundation, *Submission 5*, p. 1; Australian Lung Foundation, *Submission 7*, p. 1.

6 Australian Council on Smoking and Health, *Submission 1*, p. 1.

7 Action on Smoking and Health Australia, *Submission 3*, p. 1.

8 Australian Lung Foundation, *Submission 7*, pp 1–2.

9 Quit Victoria, *Submission 2*, p. 1.

10 Royal Australasian College of Physicians, *Submission 9*, p. 1.

11 Royal Australasian College of Physicians, *Submission 9*, p. 2.

1.10 A further matter of significant concern is that Australia is a signatory to the World Health Organisation Framework Convention on Tobacco Control (FCTC). The FCTC includes obligations to protect health policies from the tobacco industry.¹² Article 5.3 of the FCTC states that:

In setting and implementing their public health policies with respect to tobacco control, Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law.¹³

1.11 In November 2008, the World Health Organisation FCTC governing body adopted guidelines for the implementation of FCTC Article 5.3, which included a recommendation that:

Parties that do not have a State-owned tobacco industry should not invest in the tobacco industry and related ventures. Parties with a State-owned tobacco industry should ensure that any investment in the tobacco industry does not prevent them from fully implementing the WHO Framework Convention on Tobacco Control.¹⁴

1.12 Many witnesses pointed to these obligations and questioned the Future Fund's investment in some 14 tobacco companies.¹⁵ The RACP commented that 'it is difficult to understand how the Future Fund's investments in tobacco producers are not in the very least inconsistent with the intent of the FCTC'.¹⁶

1.13 While the Future Fund has been made aware of the FCTC through representations of organisations such as ASH, it has chosen not to act on the divestment of its investments in tobacco entities. ASH stated:

We did write to the former chief, David Murray, and also to the relevant ministers, including Penny Wong. I suppose the most positive response, if we could put it that way, was that they are going to review their investment strategy, but that is about as far as it went. We drew to their attention the legal treaty obligations, but they did not refer back to those in any response.¹⁷

1.14 The Greens note that that the Department of Health and Aging submission stated that should the proposed Ethical Investments bill be passed, its intent to specify prohibited financial assets, including investment in tobacco companies, would accord

12 Quit Victoria, *Submission 2*, p. 1; Action on Smoking and Health Australia, *Submission 3*, p. 1; National Heart Foundation, *Submission 5*, p. 2.

13 World Health Organisation, *Framework Convention on Tobacco Control*, 2005, p. 7.

14 World Health Organisation, *Guidelines for the implementation of Article 5.3 of the WHO Framework Convention on Tobacco Control*, decision FCTC/COP3(7), November 2008, p. 8.

15 Heart Foundation, *Submission 5*, p. 2.

16 Royal Australasian College of Physicians, *Submission 9*, p. 2.

17 Ms Anne Jones OAM, CEO, Action on Smoking and Health Australia, *Committee Hansard*, 8 August 2012, p. 10.

with Article 5.3 of the FCTC.¹⁸ Indeed, the Government pursued reforms including the *Tobacco Plain Packaging Act 2011*, which was upheld by the High Court on 15 August 2012. It is quite perplexing that despite the above achievements, hundreds of millions of dollars of public funds continue to be invested in tobacco companies as part of the holdings of the Future Fund.

Nuclear weapons

1.15 In terms of the impacts of Nuclear Weapons, the International Campaign to Abolish Nuclear Weapons (ICAN) indicated that in its view nuclear weapons are the most destructive, inhumane and indiscriminate instruments of mass murder ever created:

Physicians and scientists have long studied and documented the medical consequences of nuclear war, concluding that human security and survival depend upon ridding the Earth of these indefensible weapons. Even if a nuclear weapon were never again exploded over a city, there are effects related to the production, testing and deployment of nuclear arsenals that are experienced as an ongoing personal and community catastrophe by many people around the globe.¹⁹

1.16 ICAN suggested that nuclear weapons are the only devices ever created with the capacity to destroy all complex life forms on Earth within a relatively short period and provided further evidence to quantify the effects of nuclear weapons:

A war fought using 1000 nuclear weapons – around 5% of the total global stockpile – would render the planet uninhabitable. In addition to causing tens of millions of immediate deaths, a regional nuclear war involving around 100 Hiroshima-sized weapons would disrupt the global climate and agricultural production so severely that more than a billion people would be at risk of famine.²⁰

1.17 ICAN supported the Bill and suggested that ongoing investments in entities involved with nuclear weapons may be in conflict Australia's disarmament obligations and may undermine Australia's disarmament activities.²¹ Australia's international law obligations include compliance with the Geneva conventions, UN charter, the Non-Proliferations Treaty, the Comprehensive Nuclear Test Ban Treaty, and the South Pacific Nuclear Free Zone Treaty. ICAN informed the committee that:

None of these treaties expressly prohibit Australia from investing in nuclear weapons companies. However, the South Pacific Nuclear Free Zone Treaty forbids Australia from facilitating the manufacture of nuclear weapons anywhere in the world, and the NPT requires Australia to advance nuclear disarmament. Additionally, the simulated testing of nuclear weapons

18 Department of Health and Ageing, *Submission 13*, p. 1.

19 International Campaign to Abolish Nuclear Weapons Australia, *Submission 6*, p. 8.

20 International Campaign to Abolish Nuclear Weapons Australia, *Submission 6*, p. 8.

21 International Campaign to Abolish Nuclear Weapons Australia, *Submission 6*, p. 1.

carried out by the company Honeywell International, in which the Future Fund invests, is clearly against the spirit of the CTBT.²²

1.18 Oxfam also suggested that under instruments like the OECD's Guidelines for Multinational Enterprises issues of an investor's complicity for the activities of a company in which it has invested have become a more prevalent consideration. Oxfam stated that:

Those obligations, and consequences, fall equally on states seeking to intervene in private markets under similar conditions. ... 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.²³

1.19 ICAN asserted that there is significant support in Australia for the divestment of entities involved with nuclear weapons, drawing attention to the parliamentary resolution on support for a world free of nuclear weapons:

There was a rare display of bipartisan support in the Australian parliament in March this year for a parliamentary resolution on the unanimous recommendations of the Joint Standing Committee on Treaties affirming the Australian parliament's support for the goal of a world free of nuclear weapons and the exploration of legal frameworks for their abolition. I think there is an extraordinary depth of support for the position that nuclear weapons are an enormous threat and Australia's objective is their elimination. Therefore, the divestment of public funds from their manufacture would be an important pro-health and pro-sustainability position to take, and I think it would be a very desirable development for the Future Fund and would build on its commendable divestment of its investment in cluster munitions—companies that manufacture those.²⁴

Reputation impacts

1.20 The Future Fund's investment mandate requires the Board to consider the impacts of its investments, including acting in a way that is unlikely to cause any diminution of the Government's reputation in financial markets.²⁵

1.21 The Future Fund and the Department of Finance and Deregulation (the department) both argued that the reputation of the Future Fund is very important to its ability to conduct its commercial operations and that the Bill would damage its reputation.²⁶ However, evidence was received from the witnesses which pointed to the

22 International Campaign to Abolish Nuclear Weapons Australia, *Submission 6*, p. 7.

23 Oxfam, *Submission 10*, p. 10.

24 Associate Professor Tilman Ruff, Chair, Management Committee, ICAN Australia, *Committee Hansard*, 8 August 2012, p. 2.

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

26 Mr Mark Burgess, Future Fund Management Agency, *Committee Hansard*, 8 August 2012, pp 29–31.

very real risks for the Government's reputation that continued invest in entities involved in tobacco and nuclear weapons will have. The National Heart Foundation commented on the damage to the Government's 'unblemished record on tobacco control' that resistance to disinvestment in tobacco will cause.²⁷ The RACP also argued the Government's leadership in in global efforts to minimise the harm from tobacco use will be undermined.²⁸

Responsible/Ethical Investment practices

1.22 In addition to the background material set out in chapter 1 of the committee's report, in this section we draw attention to some further information on responsible and ethical investment. As noted in chapter 1 there has been a steady development of Sovereign Wealth Funds (SWFs) since the 1970s and they now have very significant impacts on investment markets. Over a similar period and following on from earlier specific examples there also been considerable interest in and development of responsible and ethical investment practices.

Responsible investment is a practice that has evolved and matured within the last four decades and now encompasses a broad range methodologies and approaches. ... Common words used in this space include ethical investment, sustainable investment and socially responsible investment.²⁹

1.23 Responsible/ethical investment is now a healthy and growing aspect of the investment industry and is instrumental in improving investment strategy and processes. Australian institutional investors have been recognised through signatory support of the United Nations Principles for Responsible Investment (UN PRI):

In fact Australia boasts the largest proportionate signatory base in the world, resulting in over 60% of all funds under management in Australia now being part of that global program.³⁰

1.24 Oxfam suggested that responsible/ethical investment has particular applicability to sovereign wealth funds, with Norway and New Zealand being excellent examples. Oxfam went to note that:

This applicability derives from the peculiar position of a sovereign wealth fund as a form of public institution but one which operates in the investment market as a private investment actor. Unlike other solely private actors, sovereign wealth funds have additional responsibility to comply with international law and the obligations entered into by their host states. ...Incorporating a transparent responsible investment approach will formalise and deliver clarity to the market on precisely when, where and

27 National Heart Foundation, *Submission 5*, p. 2.

28 Royal Australasian College of Physicians, *Submission 9*, p. 1.

29 Responsible Investment Association Australasia, *Submission 11*, p. 1.

30 Responsible Investment Association Australasia, *Submission 11*, pp 2–3.

how Australia's sovereign wealth funds will balance their public obligations with their private functions.³¹

Precedents

1.25 While the Future Fund and the department listed some precedents in their submissions,³² there are a range of international precedents for both legislative and regulatory arrangements that are worth drawing attention to.

1.26 The European Sustainable Investment Forum (EUROSIF) is a pan-European network and think-tank focussed on developing sustainability through European Financial Markets. In its 2010 study which details the 2010 status of Sustainable and Responsible Investment developments in each European country, EUROSIF reported that 63 per cent of the assets subjected to Sustainable and Responsible Investment criteria were held by public pension funds or reserve funds³³ and that:

Currently, at least eight countries in Europe have specific National SRI regulations in place that cover their pension systems: United Kingdom (2000), Germany (2001), Sweden (2001), Belgium (2004), Norway (2004), Austria (2005) and Italy (2005). Spain is in the process of introducing such SRI requirements into the existing 2002 Pension Funds law. In Italy, the disclosure obligations applying to all complementary pension funds started in January 2008.³⁴

1.27 Some laws and/or regulations are focussed specifically on SWFs or pensions funds, while others that have substantially broader application to investors generally have also been explored:

The Dutch Parliament recently passed a resolution to ban cluster munitions for all Dutch investors, which was overturned by the interim Minister of Finance.³⁵

1.28 Assets managed with a simple exclusion strategy mostly originate in the Netherlands, Italy, Belgium and Sweden, and represent up to 1.0 trillion euros of investment.³⁶ In terms of specific developments in individual countries there are several, including the following examples, most of which relate to pension or sovereign wealth funds:

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

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

33 European Sustainable Investment Forum, *European SRI Study*, revision edition 2010, p. 16.

34 European Sustainable Investment Forum, *European SRI Study*, revision edition 2010, p. 19.

35 European Sustainable Investment Forum, *European SRI Study*, revision edition 2010, p. 42.

36 European Sustainable Investment Forum, *European SRI Study*, revision edition 2010, p. 14.

- Belgium – since 2007 financial institutions, whether public or private, have been prohibited from investing in companies that produce cluster munitions.³⁷ Investments in depleted uranium weapons are now also prohibited;³⁸
- Italy – the Assicurazioni Generali insurance company decided in 2006 to invest all of the assets managed by the Group's companies (€99 billion in 2009) in accordance with the ethical guidelines adopted by the Norwegian Government Pension Fund;³⁹
- France – since 2001 the Pension Reserve Fund has a legislated commitment to SRI and an explicit long-term outlook.⁴⁰ Other legislation bans both direct and indirect financing of cluster munitions production.⁴¹ In addition more than half of the Core SRI market is also subject to land mine and cluster bomb exclusions;⁴²
- Sweden – the state pension buffer funds have been followed by other organisations in adopting SRI practices, which include screening on environmental aspects, weapons and tobacco;⁴³
- USA – the California Employees' Retirement System is a large pension fund, which has had a responsible investment framework for many years that relates to human rights labour conditions;⁴⁴
- Luxembourg and New Zealand – have criminalised investment by public or private entities in companies that produce cluster munitions;⁴⁵
- Ireland – has banned investment of public money in cluster munitions producers;⁴⁶ and

37 Human Rights Watch, *Promoting the Prohibitions, The Need for Strong Interpretations of the Convention on Cluster Munitions*, November 2010, p. 10.

<http://www.hrw.org/en/news/2010/11/06/promoting-prohibitions> (accessed 6 July 2012).

38 European Sustainable Investment Forum, *European SRI Study*, revision edition 2010, p. 25.

39 European Sustainable Investment Forum, *European SRI Study*, revision edition 2010, p. 14.

40 University of Technology Sydney, Institute of Sustainable Futures, *Mainstreaming Socially Responsible Investment (SRI): A role for Government*, November 2005, p. 2.

41 Human Rights Watch, *Promoting the Prohibitions, The Need for Strong Interpretations of the Convention on Cluster Munitions*, November 2010, p. 10.

<http://www.hrw.org/en/news/2010/11/06/promoting-prohibitions> (accessed 6 July 2012).

42 European Sustainable Investment Forum, *European SRI Study*, revision edition 2010, p. 32.

43 European Sustainable Investment Forum, *European SRI Study*, revision edition 2010, p. 49.

44 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. 37.

45 Human Rights Watch, *Promoting the Prohibitions, The Need for Strong Interpretations of the Convention on Cluster Munitions*, November 2010, p. 10.

<http://www.hrw.org/en/news/2010/11/06/promoting-prohibitions> (accessed 6 July 2012).

- UK – since 2010, the direct financing of cluster munitions production is prohibited, however indirect financing of cluster munitions is not.⁴⁷

1.29 A detailed list of countries and financial institutions that exclude investment in cluster munitions is also now published annually, identifying entities in both a hall of fame and hall of shame.⁴⁸

1.30 Submitters pointed to Norway's Government Pension Fund Global (GPF) as a model for ethical investments. The GPF strongly considers ethics and human rights in its investment objectives and is perceived as an activist shareholder. The GPF also uses exclusions in some cases and is required to not invest in, or divest from, companies that: produce weapons that violate fundamental humanitarian principles; produce tobacco; sell weapons or military material to specific countries highlighted in the GPF's guidelines.⁴⁹ In January 2010, the Norwegian Ministry of Finance agreed to exclude 17 tobacco-producing companies from GPF, based on a recommendation from the Fund's Council on Ethics.⁵⁰

1.31 The New Zealand Superannuation Fund (NZSF) has had a responsible investment policy for several years and began excluding companies involved with tobacco in 2007, and companies involved with cluster bombs and nuclear weapons in 2008. The background to those decisions is documented and made available publicly.⁵¹ A full list of exclusions as at 31 December 2011 is also publicly available.⁵²

1.32 The NZSF noted in its 2010–11 annual report that the *New Zealand Superannuation and Retirement Income Act 2001* requires that the overall Statement of Investment Policies, Standards and Procedures (SIPSP) must cover ethical investment including policies, standards and procedures for avoiding prejudice to New Zealand's reputation as a responsible member of the world community. The SIPSP

46 Human Rights Watch, *Promoting the Prohibitions, The Need for Strong Interpretations of the Convention on Cluster Munitions*, November 2010, p. 10.
<http://www.hrw.org/en/news/2010/11/06/promoting-prohibitions> (accessed 6 July 2012).

47 Foreign and Commonwealth Office, *The financing of Cluster Munitions Production*, Written Ministerial Statement, 7 December 2009,
<http://www.stopexplosiveinvestments.org/uploads/pdf/UK%20Ministerial%20statement.pdf>, (accessed 6 July 2012).

48 IKVPAX CGRRISTI & FAIRFIN, *Worldwide investment in cluster munitions a shared responsibility*, June 2012 Update, pp 23–24.

49 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. 37.

50 European Sustainable Investment Forum, *European SRI Study*, revision edition 2010, p. 14.

51 New Zealand Superannuation Fund, *Exclusion decisions*,
<http://www.nzsuperfund.co.nz/index.asp?pageID=2145883153>, (accessed 3 July 2012).

52 New Zealand Superannuation Fund, *Companies excluded from New Zealand Superannuation Fund as December 2011* <http://www.nzsuperfund.co.nz/index.asp?pageID=2145883153>, (accessed 3 July 2012).

includes a responsible investment framework to address ESG issues, which has work streams closely aligned with UNPRI. The annual report sets out the NZSF activities undertaken under the work streams.⁵³

Impact on returns

1.33 It is a common criticism of responsible and ethical investment that, by restricting the diversity of investments (the investible universe), investment returns are automatically going to be restricted. RIAA disputed those criticisms, stating that:

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. The two statements do not link.⁵⁴

1.34 Oxfam supported the above view and indicated that, in its view, returns over both the short and long term can be enhanced:

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.⁵⁵

...in the Canadian equity fund class, the average of responsible investment funds outperformed the average of all Canadian investment funds on a one, three, five and 10-year basis. We cite that 11 of the 15 funds in that category outperformed the industry average on a one-year basis. That is one example and there are other examples both in our submission and beyond that.⁵⁶

1.35 The RIAA submitted a summary of analysis to demonstrate examples of enhanced returns for responsible and ethical investment:

The RI Annual Benchmark Report of 2011, produced annually by RIAA, demonstrates how specialist responsible investment funds have outperformed their benchmarks in every one of the twelve categories covered in the report over one, three, five and seven years across Australian shares, international shares and balanced funds.⁵⁷

1.36 ASH submitted other evidence of enhanced returns in Australia:

53 New Zealand Superannuation Fund, *Annual Report 2010-11*, pp 36–44.

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

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

56 Mr James Ensor, Policy Director, Oxfam, *Committee Hansard*, 8 August 2012, p. 3.

57 Responsible Investment Association Australasia, *Submission 11*, p. 2.

Grouped together, "ethical" funds are outperforming their mainstream counterparts. According to Morningstar, Australian share funds that invest ethically produced an average annual return of 4.65% over the five years to July 31, 2010, compared with 4.21% for mainstream share options.⁵⁸

1.37 Additional evidence was provided by Mr Tomohiro Matsuoka which drew attention to international experience on maintaining financial performance while investing responsibly, including when screening companies involved with landmines and cluster bombs:

Many of the European financial institutions practising SRI already have a long history of doing so, and there is no specific evidence that it affects their financial performance.

For those practising responsible investment—such as screening companies for involvement with antipersonnel landmines or cluster munitions—there is no record that they underperform. There is no track record of that. So there is no evidence that practising responsible investment damages financial performance.⁵⁹

1.38 Information from the Future Fund supports the above arguments. Prior to its divestment, the rates of return the Future Fund was achieving on its investments in companies involved with cluster bombs, were negative for most of the companies.⁶⁰

1.39 The Future Fund has \$179 million invested companies involved with nuclear weapons,⁶¹ and \$225 million in companies involved with tobacco.⁶² Put together these represent a less than half of one per cent of the total value of the Future Fund. Therefore it is hard to see how it could be justifiably claimed that divesting those companies would have a material impact on overall fund returns. Information from New Zealand supports this argument:

The NZSF noted that its total tobacco company holding amounted to just 0.29 per cent of the total fund. In their decision, the Guardians noted that divestment from the tobacco sector would have an immaterial effect on the expected efficiency...of the Fund's portfolio. This is almost identical to the Future Fund, whose estimated \$225 million holding represents 0.29 per cent of the \$77.05 billion total (as at 31 March 2012).⁶³

1.40 The Australian Lung Foundation also suggested that investments in tobacco companies were not needed to achieve the Future Fund's target returns. The Australian

58 Action on Smoking and Health Australia, *Submission 3*, p. 2.

59 Mr Tomohiro Matsuoka, *Committee Hansard*, 8 August 2012, p. 15.

60 Future Fund, Answer to question on notice No. 3, received 27 July 2012.

61 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, (accessed 5 July 2012).

62 Future Fund, Answer to question on notice F65, *Estimates Hansard*, 14 February 2012.

63 Royal Australasian College of Physicians, *Submission 9*, p. 4.

Lung Foundation cited the example of First State Super's exclusion of companies involved with the manufacture of cigarettes and other tobacco products:

On the 19th of July 2012, First State Super announced that they have excluded companies involved in the manufacture of cigarettes and other tobacco products from their entire investment portfolio.

In the announcement, CEO Mr Michael Dwyer stated that their decision will have inconsequential impact on investment returns.⁶⁴

1.41 Based on the above arguments, it is therefore possible to conclude that responsible/ethical investment is a well-known, well-developed and appropriate path for the Future Fund to take, that will not have a material impact on returns and is likely to enhance its reputation.

Applicability to the Future Fund

1.42 The applicability of responsible/ethical investment practices to investment managers has been previously addressed, from a reporting perspective:

The *Financial Services Reform Act 2001* requires product disclosure statements issued in respect of managed investment funds and other investment products to disclose the extent to which labour standards or environmental, social or ethical considerations have been taken into account by the manager of the fund or product in selecting, retaining and realising investments.⁶⁵

1.43 A suggestion that the Future Fund adopt a responsible investment policy was made as early as November 2005 by the Institute of Sustainable Futures at the University of Technology Sydney.⁶⁶

1.44 Prior to the establishment of the Future Fund, the Senate Economics Legislation Committee noted the appropriateness of including important principles in the directions to be given to the Board under the investment mandate.⁶⁷ That committee also heard evidence from Mr Easterbrook of Corporate Governance International that:

...the Future Fund provides a major opportunity to be a market leader in terms of best practice...two particular areas for consideration, specifically voting policy and engagement with companies in which a shareholding is held.⁶⁸

64 Australian Lung Foundation, *Submission 7*, p. 2.

65 Paul U Ali and Martin Gold, Stellar Capital and The University of Melbourne Centre for Corporate Law and Securities Regulation, *An appraisal of socially responsible investments and implications for trustees and other investment fiduciaries*, June 2002, p. 2.

66 University of Technology Sydney, Institute of Sustainable Futures, *Mainstreaming Socially Responsible Investment (SRI): A role for Government*, November 2005, p. 2.

67 Senate Economics Legislation Committee, *Provisions of the Future Fund Bill*, p. 10.

68 Senate Economics Legislation Committee, *Provisions of the Future Fund Bill*, p. 10.

1.45 The Future Fund has set up ESG policies and claims that it is pursuing global best practice.⁶⁹ Other witnesses such as RIAA and Mr Matsuoka rejected that view. RIAA stated:

Not wishing to sound critical of what they are doing, I do not think the Future Fund is achieving best practice in all of the different aspects of the UN PRI that are out there. Certainly I am thinking here in terms of reporting and things like that.⁷⁰

1.46 Mr Matsuoka went on to comment:

To be honest, I have a bit of a sceptical view about the current practice of the Future Fund. I think they can do even more. I just read the response from the Future Fund. If they are prepared to provide this kind of answer, then I think they are able to practice more responsible investment. To set the very basic mandate, it is good to have legislation.⁷¹

1.47 When asked about influencing the behaviour of tobacco companies under its ESG policy, the Future Fund stated that:

...we do apply our environmental and social governance policies clearly against all of our investments as well, so where we invest in any industry we ensure, for example, that the industry is acting in the right way, is adhering to the best corporate principles and is doing the right thing by its fiduciary duties.⁷²

1.48 Quit Victoria, however, rejected the view that influencing the behaviour of tobacco companies was of any value:

There is no improvement on a tobacco product, I think. As you say, \$200 million or whatever is invested in the tobacco industry is funding their activities, and essentially one in two people who uses their product dies. There is no safe level of smoking. There is nothing we can do to tobacco products to make them safer.⁷³

1.49 Continuing to invest in entities involved with tobacco and nuclear weapons also provides clear evidence that the Future Fund is not currently operating at best practice. Oxfam saw the Bill as being able to bring the Future Fund into alignment with best practice:

Responsible Investment has developed in light of this recognition, and its incorporation into the investment practices of the Target Funds through this

69 Mr Mark Burgess, Managing Director, Future Fund Management Agency, *Committee Hansard*, 8 August 2012, p. 29.

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

71 Mr Tomohiro Matsuoka, *Committee Hansard*, 8 August 2012, p. 16.

72 Mr Mark Burgess, Managing Director, Future Fund Management Agency, *Committee Hansard*, 8 August 2012, p. 28.

73 Ms Fiona Sharkie, Executive Director, Quit Victoria, *Committee Hansard*, 8 August 2012, p. 10.

Bill will see Australia again at the forefront of best-practice in the financial and investment sector.⁷⁴

We recommend to the committee that it support the adoption of responsible investment as an investment strategy, because it is compatible with the legal obligations of investors, as well as being essential to best practice risk management.⁷⁵

1.50 During the inquiry, some concerns about responsible and ethical investment were raised. ASH countered the four most common arguments that are used by opponents of responsible investment guidelines:

The first one is that it [tobacco] is a legal product. There are lots of products that are legal—munitions, methadone, pornography—but many of these are restricted for social and health reasons...

The second common argument is that funds should be independent and free of political interference. The Future Fund Act, subsection 18(10) requires the board to maximise returns consistent with international best practice and subject to any conditions given by the responsible ministers under subsection 18(1)...

The third common argument is that a fund's duty is to its investors. The duty of an investment fund is to maximise returns for its members—we know that—usually subject, however, to some direction and in accordance with best practice...complying with treaty obligations like the FCTC...

Lastly, a common argument is that tobacco is a good investment. Economic evidence shows that funds can perform well if not better if they adopt socially responsible investment guidelines. In contrast, the tobacco industry has been described as a sunset industry. Its long-term future is in doubt.⁷⁶

1.51 Another criticism of responsible and ethical investment is that it is too difficult to work out what companies are involved in. For example, the Future Fund claimed in its response to questions on notice that it was not able to identify whether companies it had invested in, were involved with nuclear weapons.⁷⁷ Other witnesses, including ICAN, rejected that view:

The companies that we have included in our submission, as the Future Fund having investments in, are not companies that are producing paperclips, dual-use items or things that are not specific to nuclear weapons or their delivery systems. These are companies that are integrally involved in the production of key nuclear weapons and delivery system components. In our report we have applied certain benchmarks for the size of the engagement and for the specificity of the involvement. I think there are ways of doing this in a transparent and consistent way, but I would certainly

74 Oxfam, *Submission 10*, p. 6.

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

76 Ms Anne Jones OAM, CEO, Action on Smoking and Health Australia, *Committee Hansard*, 8 August 2012, p. 9.

77 Future Fund, Answers to questions on notice Nos 2 and 3, received 27 July 2012.

argue that key components of nuclear weapons and their delivery systems that are really integral and essential for those are possible to define.⁷⁸

1.52 Some other criticisms that are specific to the Bill were made during the inquiry. One of the criticisms was that the Bill does not specify in detail the definitions or universe of proscriptions that would or could apply. While the issues raised around clarity are valid, it is anticipated that the responsible Ministers (in conjunction with the Future Fund) would ensure that adequate detail was present in the *Future Fund Ethical Investment Guidelines* required by the Bill.

1.53 The issue of a hierarchy of priorities, or competing priorities between the Investment Mandate and the Ethical Investment Guidelines is a valid concern. This matter can be easily resolved by clarifying the relationship clearly in the guidelines or in the Mandate.

1.54 Some of the concern expressed was about ambiguities in the proposed Guidelines. This would be a matter for the responsible Ministers to resolve according to the powers granted to them by the Bill. However, I note that these concerns did not apply to a simple list of exclusions which could be introduced as a short-term alternative to accomplishing the Bill's stated purpose in causing the fund to divest of tobacco and nuclear weapons stocks.

Independence of the Future Fund

1.55 A key issue raised during the inquiry was the independence of the Future Fund from government and I acknowledge the importance of that independence. The proposed guidelines should allow continued independence regarding individual investment decisions as set out in section 18A of the *Future Fund Act 2006* (FF Act). To facilitate independence, the Future Fund could develop the guidelines and provide them to the Government and Parliament for approval.

1.56 It is worth noting that existing powers under section 18 of the FF Act may be sufficient to bring about the changes sought. The existing powers of the responsible Ministers could be used to issue a new investment mandate that emphasised responsible investment without specific exclusions or interference. It is also within the Fund's powers to make those exclusions themselves without any change as they did with cluster munitions. The Bill has specific advantages in terms of making the changes explicit and ensuring that they are endorsed by Parliament.

1.57 In addition to the above safeguards, the Future Fund has contributed to the development of the Santiago Principles, which are among other things, designed to mitigate political interference in the operation of sovereign wealth funds. Oxfam submitted that:

The Santiago Principles 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

78 Associate Professor Tilman Ruff, Chair, Management Committee, ICAN Australia, *Committee Hansard*, 8 August 2012, p. 4.

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.⁷⁹

1.58 During the inquiry it was also pointed out that the Bill would influence the investment practices of the government and its affiliated bodies, and in doing so, would function as exemplary to wider financial communities both within Australia and outside Australia.⁸⁰ Mr Matsuoka informed the committee that the European and New Zealand responsible investment initiatives had a huge impact on the financial community:

...because not only was it, first of all, a sovereign fund but it was also prescribed in the legislation. It did not specifically designate responsible investment; however, the first CEO of the New Zealand Super Fund interpreted this legislation as meaning practising responsible investment, and this became a kind of model in the industry.⁸¹

That is the case in Northern Europe. I mentioned the Norwegian fund case. That set the example in the industry. It is getting more widespread among particularly super funds, both public and private, in Northern Europe.⁸²

1.59 The RIAA also supported this view, submitting that:

The consideration of ESG issues by large institutional investors such as government investment funds is therefore not just an issue of enlightened self-interest, but plays a key role in improving overall market standards, generating better market returns and reducing systemic risk.⁸³

Conclusion

1.60 Evidence presented to this inquiry demonstrates that the harm caused by tobacco, nuclear weapons and cluster bombs is devastating both to Australia and other countries. While it is good that the Future Fund has divested its investments in entities involved with cluster bombs, it seems clear that it will not divest its investments in entities involved in tobacco and nuclear weapons of its own accord under its current governance arrangements. This state of events is both unnecessary and ethically untenable, creating a clear need to establish better governance arrangements to empower the Future Fund to make the necessary divestments.

79 Oxfam, *Submission 10*, p. 11.

80 Mr Tomohiro Matsuoka, *Submission 4*, p. 2.

81 Mr Tomohiro Matsuoka, *Committee Hansard*, 8 August 2012, p. 15.

82 Mr Tomohiro Matsuoka, *Committee Hansard*, 8 August 2012, p. 16.

83 Responsible Investment Association Australasia, *Submission 11*, p. 3.

1.61 The Bill seeks to make measured and appropriate changes to the governance arrangements. The changes would make explicit, powers that arguably already exist under the *Future Fund Act 2006*. There are precedents in private industry and international sovereign wealth funds for responsible investment practices, such as those proposed in the Bill. Evidence from a range of sources suggests that returns will not be compromised. For tobacco and nuclear weapons in particular, they represent such a small fraction of the Future Funds' total value, that it is highly unlikely that divestment would have any material impact on returns.

Recommendation 1

1.62 The Australian Greens recommend that the Bill be amended to clarify the interaction between the Investment Mandate and the Ethical Investment Guidelines.

Recommendation 2

1.63 The Australian Greens recommend that the Government Investment Funds Amendment (Ethical Investments) Bill 2011 be passed.

**Senator Richard Di Natale
Senator for Victoria**

