The Australian Society for Medical Research

The ASMR Executive

20 September 2021

Senate Finance and Public Administration Committees
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Re: Submission on the **Investment Funds Legislation Amendment Bill 2021** from The Australian Society for Medical Research (ASMR)

Thank you for the opportunity to comment on this draft legislation.

Founded in 1961, the ASMR is the peak organisation representing the Australian health and medical research sector through its public, political and scientific advocacy. In addition to its core membership of health and medical researchers, the ASMR has affiliations with specialist societies, medical colleges, and patient foundations/groups that effectively expand ASMR's network to more than 100,000 stakeholders of Australian health and medical research.

The Medical Research Future Fund (MRFF) was established on 26 August 2015 to provide additional funding for medical research and medical innovation. The fund was fully capitalised at $20 billion in the 2020-2021 financial year and the corpus was intended to be maintained in perpetuity. Investment of the MRFF is overseen by the Future Fund Board of Guardians and must achieve a mandated return of the RBA cash rate + 1.5-2% p.a., net of costs, over a 10-year rolling term. The investment mandate allows the Future Fund Guardians to "determine an acceptable but not excessive level of risk" for investment, with the revenue to be fully disbursed back into health and medical research, to effectively double the annual investment through the NHMRC and MRFF combined. The MRFF Special Account falls under the Department of Finance and the Department of Health makes annual requests for credit of the MRFF Special Health Account, from which annual disbursements for grants and initiatives are made. The level of disbursement for a given year was to be determined by the Future Fund Board of Guardians based on the return on investment from the previous year.

The ASMR has several points to raise with regard to the proposed amendments of the *Medical Research Future Fund (MRFF) Act 2015* outlined in the ***Investment Funds Legislation Amendment Bill 2021***. It is our opinion that some of the proposed changes are sub-optimal and not consistent with the original intent of the MRFF, while other changes are not sufficiently justified and may impact the outcomes from this unique health and medical research endowment.

Major points of concern from the proposed amendment Bill

POINT 1

Now that the MRFF is fully capitalised, the methodology for calculating the maximum annual disbursement from the MRFF will be simplified by specifying fixed maximum disbursement amount of $650 million per year from 2022-2023.

Background information

Initial intentions from the Government were that the MRFF would add an extra $1 billion per annum (p.a.) to health and medical research funding per annum by 2022-2023[1-3]. This level of annual revenue from the fund has been indicated in forward estimates of investment return in the Department of Finance Portfolio Budget Papers since the 2018-2019 Budget[4]. In the latest Finance Portfolio Budget Papers it was indicated that last financial year the MRFF investment returned over $1 billion of revenue, after accounting for management fees. It is apparent from the forward projections in the Finance Portfolio Budget Papers that there is expected to be $900 million to $1 billion annual return on investment as far as projections have been made to 2024-2025.

However, since the 2019-2020 Budget, there has been indication in Health Department forward estimates that the annual disbursement of the MRFF would not exceed $650 million p.a. [5]. This suggests that capping disbursements has been a long-term goal of the Government, although the purpose of this is unclear, particularly given the original intention to disburse $1 billion per year and the legislated responsibility of determining annual disbursement levels falling to the Future Fund Board of Guardians based on revenue from a given year. Additionally, even with disbursements less than $650 million p.a. to date, the MRFF credit balance has risen well above the nominal corpus of credits ($20 billion).

Independent modelling of the benefit-cost-ratio of investment into health and medical research from the MRFF is estimated to return $3.39 in future health and productivity gains for every $1 invested[6]. A failure to maximise disbursements from the MRFF (e.g. $1 billion p.a. by 2022-2023), represents a missed opportunity to optimise economic and social returns on investment into health and medical research.

Specific points of concern

1) If a maximum limit is to be set on annual disbursements, why is it not more ambitious and in line with the original aspiration of $1 billion per year? Further, as the proposed change will introduce an upper limit but no lower limit, it is possible that actual disbursements could be anything less than $650 million (but not more).

2) There is no evidence-based approach or indication of a target balance at which the MRFF Special Account would be considered sustainable? Presumably this would be iterative as associated management fees, costs of healthcare and market fluctuations change.

3) There is no indication of how/where excess funds over and above the corpus will be used, particularly once the target balance for sustainability is reached. This would also be impacted by a maximum disbursement cap.

Recommendations for specific points of concern

1) If the amendments are to provide certainty and ensure sustainability, then instead of an upper cap, the MRFF should guarantee minimum annual disbursements at an appropriate and feasible level, such as the originally proposed $1 billion per year. Any excess should be absorbed into the MRFF for sustainability or be disbursed for health and medical research, accordingly.

2) High-level modelling of increasing balance versus return on investment, along with projections of market downturn or global crisis impact, should be used to inform an MRFF balance at which the fund will be considered sustainable and disbursements can be made to a maximum. Ideally, a detailed plan would be provided before legislating these changes.

3) There is provision in the *MRFF Act 2015* that any additional funds over the corpus must stay with the MRFF endowment. We believe that any excess should be maintained until a sustainable level is reached based on modelling above in 2), at which time funding disbursements should reflect net return on investment per year.

   Another option may be to mandate that excess funds be reinvested into medical research through the NHMRC Medical Research Endowment Account (MREA), which funds the people and the basic research required to feed the MRFF translational/commercialisation aspirations. This would be an excellent use of the excess funds, as investment into the MREA has been static for over a decade and grant funding rates are at historic lows.

4) If the amendment to remove the Future Fund Board from managing the MRFF investment is to pass then there will need to be more detail, transparency and specific legislative processes around controlling how great the return on investment needs to be to make the fund sustainable into the future. Ideally, decision making should be performed by a committee independent of ministries that has clear and transparent reporting lines.

5) The intent should only ever be to maximise disbursements in line with the return on investment while maintaining the corpus at a minimum of $20 billion. To achieve this, a disbursement minimum should be installed, rather than a disbursement cap.

POINT 2

The responsible Ministers intend to issue a new investment mandate to the Future Fund Board following commencement of the legislation, directing it to pursue a higher average annual benchmark rate of return for the MRFF over the long term

Background information

"Since inception to 31 March 2021, MRFF investments have returned 4.2 per cent per annum against a target return of 2.7 per cent per annum. The MRFF was valued at $21.4 billion at 31 March 2021."[7]. On 30 June 2021 the MRFF balance was updated by the Future Fund Board and reported to be $22.028 billion[8]. With historical annual investment returns far exceeding the investment benchmark set out in the Government's investment mandate to the Future Fund Board of Guardians (average of 4.65% p.a. nominal returns versus 2.53% p.a. benchmarked rate[9]), the MRFF Account balance is now 10% over the corpus after only one year of full capitalisation.

Independent modelling from the ASMR's 2014 report on the extrapolated returns from investment in the MRFF[6] showed that imposing a stress similar to the global financial crisis of 2007-2008 (-5.1% return on the Australian Future Fund) on the MRFF at a credit balance of ~$7.5 billion (modelled on the MRFF in 2016-2017) would reduce the MRFF assets by ~$550 million. Extrapolating this to a fully capitalised MRFF would mean a similar stress could potentially reduce the balance by ~$1.5 billion. Thereby, without fully disbursing the revenue back into health and medical research the Government has managed to create a buffer considerable enough to be responsive to market fluctuations and crises and thus ensure a level of disbursement and the corpus is maintained.

However, the proposed short-term return on investment losses may negatively impact the disbursements available in a given year due to reduced returns with no requirement for the Government to maintain credit balances (Item 6 of the Bill), as it did in 2020 in response to lower returns due to COVID-19. In the long-term it is presumed that investment certainty and revenue

will be greater despite higher risk investments, a lack of evidence to support an investment approach, and no certainty these presumptions will bear out. The Government seeks to align the investment approach of the MRFF (i.e. RBA cash rate + 1.5-2% p.a.) with other funds managed by the Future Fund Board (i.e. CPI + 2-5% p.a.), which could see the balance of the MRFF increase considerably as has been seen for the Australian Future Fund[10]. However, there needs to be confidence and clarity that the purpose of growing the balance of the fund is to ensure that disbursements reach an optimal level to support the intentions of the fund and enhance the returns on MRFF investment into health and medical research.

Specific points of concern
There is a lack of detail, clarity and transparency as to how the increased benchmarking will be undertaken, how it will be accounted for, and the intended outcome.

1) How much of an increase in the MRFF Special Account balance is proposed to be required for sustainability of the fund and what will occur once this is met?

2) What is the projected short-term loss and long-term gain profile from increased investment risk when the current investment mandate to be superseded dictates the Future Fund Guardians "determine an acceptable but not excessive level of risk" for investment?

3) How will "excess" funds be managed and who will be responsible for these?

4) How will excess funds be protected and only used for health and medical research?

Recommendations

High-level guidance and evidence of approach should be provided to inform the processes that will be followed to balance sustainability with maximum disbursement to health and medical research to ensure optimal outcomes.

Minor points of concern from the proposed amendment Bill

MINOR POINT 1
Make state and territory governments (including state and territory government entities) eligible to receive funding directly from the MRFF Health Special Account, given their significant expertise in certain areas of health and medical research

Introducing eligibility for State and Territory Governments to be grant applicants/recipients reduces the availability of funds to researchers and increases competition for a highly sought after source of research funding, particularly if capping the maximum annual disbursement to $650 million. We don't think that State Governments and Government Departments should be able to access MRFF funding as this deviates from a competitive process.

Historically, there have been many instances where MRFF funding has been given to organisations with no contact person for accountability. We would not like to see this happen again and request a theme of transparency and accountability for all MRFF activities.

It would be necessary to understand the proportion of yearly funding to be allocated specifically to State and Territory Governments (and whether this will be capped), the application process, the types of funding requests and granting requirements, in the Bill before it is passed.

MINOR POINT 2

Extend and align the timing of the Strategy and the Priorities, to reduce the ongoing consultation burden on the health and medical research sector and reflect the enduring, long-term approach to medical research and medical innovation

The consultation burden exists but is largely due to the consultative outcomes being over-ruled in favour of priorities that suit the Department of Health. This is an issue that our members and researchers in general raise, often with regard to a lack of clarity around how and why priorities are chosen. A recent publication has shed light on the fact that there is a funding bias toward diseases with high mortality as opposed to chronic morbidity[11]. This is of note given some new figures show musculoskeletal disease to be one of the most costly disease areas yet it receives some of the lowest MRFF funding.

In addition, the recent ANAO audit of Health's management of the MRFF[12] found "There is no direct relationship between the initiatives in the 10-year Plan and the MRFF Strategy and MRFF Priorities and it is not clear how the 10-year Plan was designed". It seems necessary that the sector/stakeholders ought to understand what the priorities are better than anyone and this process, although burdensome, is essential.

In terms of lengthening the strategy and priority periods from 5 to 6 and 2 to 3 years respectively, we see no issue with this.

MINOR POINT 3

Clarify that grants can be paid in instalments (for example, to clarify that milestone payments can be paid to grant recipients)

This could be useful, but could also cause or compound issues if the Government imposes unrealistic reporting or milestone expectations.

We have a written report from an MRFF-funded researcher that highlights instalments in their funding agreement did not take into account the application budget and resulted in the potential of not being able to execute the grant accordingly:

"*The payment schedule outlined in the grant agreement does not seem to take into consideration the grant budget. For example, there is smallest payment is the first ($600,000) but the first year of the grant is the costliest (~$1.1 million). The last payment is the largest ($994,175) whereas the last year of the grant is the least costly (~$700,000).*"

There was also suggestion that there were other governance and process issues, with the Office of Health and Medical Research and DISER playing the blame game off against each other.

It was suggested in the Bill that instalments could be linked to milestone reports. The reporting processes for MRFF grants are not effectively managed at present due to the under-resourced Office of Health and Medical Research. This would be compounded if further reporting was required or made the already cumbersome process any more complicated.

Therefore, any payment instalment process needs to be sensibly governed and consistent with the grant application requirements. However, this amendment could provide more flexibility and an opportunity for high risk-high reward projects to be funded, with later stage funding contingent on successful milestone completions if executed accordingly.

MINOR POINT 4

Clarify that the Health Minister can request debits from the MRFF Special Account without having to identify each individual grant to which a debit relates (grant outcomes would continue to be transparently reported on the Department of Health's website)

Presumably this pertains to the budget request each year to Treasury for the transfer of funds for disbursement in line with the Portfolio Budgets, where the minister does not have to specify which grants it will be used for in that year as they generally haven't yet been awarded.

If this is not the case, it goes against the theme of transparency and accountability that we have sought since our consultation on the *MRFF Act 2015*. There are already red flags with the MRFF governance and ministerial involvement outlined in the recent review by the ANAO. We would seek greater transparency and accountability, not less. Complete transparency is required where public money is in question.

The statement "grant outcomes would continue to be transparently reported on the Department of Health's website" does little to qualify this amendment, particularly given the recent finding and recommendation by the ANAO audit of Health's management of the MRFF, that grants needed to be reported in the way they were classified in the grant opportunity guidelines.

Summary of recommendations

1) The capping of the annual disbursement has been indicated in forward estimates but falls short of the Governments intentions at the outset to provide an extra $1 billion into health and medical research. We would recommend a more ambitious maximum or better yet a realistic guaranteed annual minimum disbursement, as with the current amendment there would be no obligation to fund at the maximum $650 million level but could be any amount up to that maximum. This may provide some more certainty that any increase in investment return (as has been seen to date) can be used to increase annual disbursements up to an ambitious maximum or guaranteed minimum.

2) To date the investment returns from the fund have seen the endowment account rise to $22.028 billion. The government now seeks to raise the benchmark on investment return by increasing the investment risk, which is expected to lead to lower returns in the short-term that may mean lower disbursements year on year. This was seen last year when return on investment was down and the government had to top up the shortfall to meet the intended disbursement amount. With a new maximum disbursement there is nothing to say the disbursements will reach that or be topped-up if they fall short.

3) The minor points of concern seem to have the potential to reduce transparency and allow the Minister of the day more flexibility to disburse funding as they see fit. We would like to see a theme of transparency and accountability installed rather than reducing these further.

4) There needs to be some evidence-based mandate to balance maximal disbursements for health and medical research with capacity to ensure sustainability (e.g. maintain the corpus, provide a buffer for potential stressors and market fluctuations, etc.) and nominal targets need to be developed and scrutinised in order to achieve this with transparency and accountability.

5) These amendments do not address the shortcomings of the MRFF governance and processes and may decrease the transparency and accountability for certain activities. We advocate for legislated transparency, accountability and integrity in relation to all MRFF activities and particularly in relation to the *Investment Funds Legislation Amendment Bill 2021*.

Please do not hesitate to contact the ASMR for further discussion (contact details below).

Yours faithfully,

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