

2012

**THE LEGISLATIVE ASSEMBLY FOR THE
AUSTRALIAN CAPITAL TERRITORY**

**FINANCIAL MANAGEMENT (INVESTMENT) LEGISLATION AMENDMENT
BILL 2012**

EXPLANATORY STATEMENT

**Circulated by
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INTRODUCTION

This explanatory statement relates to the Financial Management (Investment) Legislation Amendment Bill 2012 (the Bill) as presented to the Legislative Assembly. It has been prepared in order to assist the reader of the bill and to help inform debate on it. It does not form part of the Bill and has not been endorsed by the Assembly.

The Statement is to be read in conjunction with the Bill. It is not, and is not meant to be, a comprehensive description of the Bill. What is said about a provision is not to be taken as an authoritative guide to the meaning of a provision, this being a task for the courts.

OVERVIEW

The Bill amends the *Financial Management Act 1996* (the FMA) and the *Territory Superannuation Provision Protection Act 2000* (the TSPPA) to better regulate the way the Territory invests public money. The Bill prohibits certain investments, sets up a mechanism for prioritising certain investments and creates the Investment Advisory Board which will have responsibility for preparing investment directions.

The intention of this Bill is to improve the way public money is invested so that investments are consistent with the objects of other Territory laws and the values of the ACT community and to ensure that funds are invested in away that promotes socially responsible and environmentally sustainable development. This intention is reflected in the new objects clause inserted in the *Territory Superannuation Provision Protection Act 2000*.

The Bill prohibits the investment of public money in four specific activities:

- 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.

The prohibition on these activities is applied where they are a material part of the company's activities. This threshold recognises that entities will have a diverse range of investment streams and that it would be almost impossible to apply an absolute prohibition where a company had any involvement in the defined activity. It is common for commercial fund managers that offer ethical, responsible or sustainable, investment options to have some level of materiality test and so this requirement should be easy to apply in practice.

In addition to these limitations the Bill also requires the Investment Advisory Board to make determinations about when it is and isn't appropriate to invest in seven other activities. These activities are listed in the proposed clause 10 new section 129D of the FMA.

The Bill builds on, and is complimentary to, the ACT's adoption of the UN Principles of responsible investment and addresses the issues raised by the standing Committee on Public Accounts in its inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010.

HUMAN RIGHTS

The Bill promotes the application of human rights protections to Territory investment practices and will only affect the activities of the Territory in regard to relevant bodies (as defined). The right to property is not affected by the Bill. All money and investments subject to the changes in the Bill is public money. That is it is not the direct superannuation fund of ACT public servants but rather the money used by the ACT to pay its liability that arises under the Commonwealth schemes of which ACT public servants are members.

DELEGATION OF LEGISLATIVE POWER

The Bill delegates the ability to create investment directions to the new Investment Advisory Board. This responsibility includes defining when investment is and isn't permissible in certain defined activities. The delegated power also extends to the ability to make additional directions in any other activities that the board wishes to address, the limitation on this is that it must be to ensure that funds are invested in away that promotes socially responsible and environmentally sustainable development.

Legislative power is also delegated to the Investment Advisory Board to create directions concerning how the Territory exercises its right to vote as a shareholder.

All these instruments are disallowable instruments and subject to the disallowance provisions in the Legislation Act.

It is reasonable to delegate these powers as they allow for an expert body to consider the particularly detailed issues in the activities defined by the Bill (or other activities as they may arise) and it is appropriate that such a body make a determination as it is not feasible for the Assembly to provide the level of detail required and review changes that will inevitably occur in the investment universe in the manner required of the Investment Advisory Board.

SUMMARY OF CLAUSES

Part 1 *Preliminary*

Clauses 1 to 3 Name of the Act, Commencement and Legislation amended

These are preliminary clauses setting out the name of the amending act, the acts amended and the commencement date. Note that as an amendment bill, section 89 of the Legislation Act provides for the repeal of the Act the day after the commencement day.

Commencement of the Act is proposed for 1 July 2013 to give sufficient time to set up the Investment Advisory Board and make the necessary changes to investment practices to ensure that the new requirements are, and can continue to be, complied with.

Part 2 *Financial Management Act 1996*

Clauses 4 and 5 New sections 38 (2) and 38 (10)

These clauses insert new requirements to ensure that investments made under the FMA also comply with any relevant investment direction made by the new Investment Advisory Board (see below notes on clause 10 new section 129D) and the prohibition on investment in defined prohibited investments (see below notes on clauses 6 (new section 38A) and 10 (new section 126)).

Clause 6 New section 38A and 38B

New Section 38A - Prohibition on investment of certain public money

This new section prevents an investment of public money in a prohibited investment and requires that if the Treasurer becomes aware that an investment has become a prohibited investment it must be divested as soon as practicable.

New Section 38B - Exercising security holder vote for investment

This new section requires that when the Territory exercises its right to vote as a shareholder because of investments under the FMA, the vote must be consistent with any relevant investment direction issued by the Investment Advisory Board relating to voting (see below clause 10 new section 129D).

Clauses 7 and 8 New Sections 58 (2) and 58 (9)

These clauses insert new requirements to ensure that investments made by Territory Authorities under the FMA also comply with any relevant investment direction made by the new Investment Advisory Board (see below notes on clause 10 new section 129D) and the prohibition on investment in defined prohibited investments (see below notes on clauses 9 (new section 58A) and 10 (new section 126)).

Clause 9 New Sections 58A and 58B

New Section 58A - Prohibition on investment of certain public money

This new section prevents an investment of public money in a prohibited investment and requires that if the Treasurer becomes aware that an investment has become a prohibited investment it must be divested as soon as practicable.

New Section 58B - Exercising security holder vote for investment

This new section requires that when the Territory exercises its right to vote as a shareholder because of investments under the FMA, the vote must be consistent with any relevant investment direction issued by the Investment Advisory Board relating to voting (see below clause 10 new section 129D).

Clause 10 New Part 9A

New Section 126 Meaning of *prohibited investment*

In order for the prohibition to apply and the investment restricted the person responsible for the investment must be satisfied on reasonable grounds that all or a material part of the revenue for a company or other investment entity is not attributable to a proscribed activity.

It is not intended that the materiality test be applied as a particularly high test and what is material will depend on the particular circumstances of a particular company or entity. For example a smaller company that derives only a very small proportion of its revenue from an activity that is only incidental or largely unrelated to its core business is unlikely to be captured by the test. However a large company may well only have a small proportion of its income that is attributable to a prohibited activity but this may be very significant in real terms and therefore satisfy the materiality test. A body would not be a prohibited investment if they derive revenue from multiple categories provided that none of that revenue is a material part of the company or entity's revenue.

The intention is that the required threshold is only applicable to contemporary circumstances and means that funds may be invested in entities that have previously received more than the permitted revenue from any of the listed activities but no longer do so and as such the Territory may now invest in them.

The clause sets out that the body's revenue must be attributable to one of the listed activities. It is not sufficient that a product may be sold and adapted to one of the listed products. For example a company makes small electric motors and in and of themselves such motors are not armaments components however it may be possible for an armaments manufacturer to use or modify them for use in an armament. This would not be sufficient to satisfy the requirements for the investment to be prohibited.

Similarly a company that derives revenue from another company that is a prohibited investment is not excluded. The requirement is that revenue comes from a particular source, the relevant issue is what the body did to receive the revenue rather than how the recipient of the product or service generated the funds to pay for that product or service. For example the fact that a stationary company sells stationary to a company that manufactures tobacco products would not exclude the stationary company as an investment option for ACT funds. Similarly software applications that can be modified for weapons or gaming purposes but are not manufactured for that purpose are not covered by the screen. The fact that they can also be used or modified for a prohibited application is not sufficient for the investment prohibition.

The four excluded categories of investment are tobacco, weapons, cosmetics that are produced using animal testing, and products produced using labor in breach of international labour agreements.

An investment is also a prohibited investment if it is prohibited by an investment direction made by the Investment Advisory Board (see below at new section 129D(3)).

New Section 127 - Definitions - pt 9A

This new section defines four important terms used in part 9A. Investment is defined by reference to the *Corporations Act 2001* (Cth) although investment in authorised deposit taking institutions is excluded from the definition as it is very difficult to know where or how these investments are subsequently used, and consistent with the application of new section 126 set out above it is not proposed that the limitation cover subsequent activity arising from the investment. Further given that it would be to administratively very difficult to include these investments and they are routinely used by many governments, for simplicity and certainty the definition explicitly excludes them from the scheme.

Relevant bodies are defined by reference to the Corporations Act. It is important to note that the definition to both direct and indirect holdings or interests and it is intended that both are covered by the prohibition. For example funds may not be invested in managed funds, pooled investment vehicles or mandated trusts that include holdings or interests in any relevant body (as defined). The definition covers both Australian domestic and international investments.

New Section 128 - Investment advisory board

This new section formally establishes the Investment Advisory Board.

New Section 129 - Functions of investment advisory board

The functions of Investment Advisory Board are to prepare and review investment directions. The specific requirements for fulfilling this function are set out in new section 129D. The Investment Advisory Board may also provide other advice to the Treasurer about investment and borrowing.

Subsection (2) requires that when exercising the functions given to the Investment Advisory Board the Investment Advisory Board must as far as practicable ensure that public money is invested in a way that promotes socially responsible and environmentally sustainable development. This mirrors the new object inserted in the TSPPA (see cause 13).

New Section 129A - Membership of investment advisory board

The new section sets out the composition of the Investment Advisory Board and the skill requirements necessary for appointment to the Investment Advisory Board. It is important that the Investment Advisory Board works consistently with the directorate and it is appropriate that there is a link between the two entities. It is for this reason that the director-general will automatically be appointed to the Investment Advisory Board as the chair. In addition between 3 and 6 other members are required to be appointed by the Treasurer.

Subsections (2) and (3) set out the necessary skills and experience, as well as the requirement that the person have professional credibility and significant standing in his or

her area of experience or expertise. This clause is modeled on the *Future Fund Act 2006* (Cth) section 38.

New Section 129B - Ending appointment of members

This is the standard provision commonly used in ACT laws in relation to the termination of statutory appointments.

New Section 129C - Investment advisory board procedures

This new section is intended to give the Investment Advisory Board a good level of flexibility around its meetings and the way it fulfills its functions. The board is required to meet once each year to ensure that the directions it issues are still relevant and appropriate.

New Section 129D - Investment directions—investment in certain activities

This new section requires the Investment Advisory Board to prepare investment directions for defined activities and for how the Territory may exercise its right to vote in resolutions put to shareholders. The new section also requires that in addition to the requirement to as far as practicable ensure that public money is invested in a way that promotes socially responsible and environmentally sustainable development set out in new section 129 the Investment Advisory Board must also give consideration to an obligation of the Territory under a territory law. Two examples of relevant laws are provided however there will be a range of other relevant laws for the particular investment directions, for example the *Gambling and Racing Control Act 1999* and the *Animal Welfare Act 1992* (including the *Animal Welfare (Amendment) Act 1997*) will also be relevant to particular directions.

The required investment directions relate to:

- gaming equipment and gambling;
- intensive animal farming;
- uranium;
- fossil fuels (coal and oil); and
- timber products.

Clause 11 Dictionary, note 2

This clause inserts ‘Corporations Act’ into the dictionary which in turn refers to the *Legislation Act 2001* which defines ‘Corporations Act’ as the *Corporations Act 2001* (Cwlth).

Clause 12 Dictionary, new definitions

This clause inserts a number of signpost definitions to various sections of the Act that define important terms.

Part 3 Territory Superannuation Provision Protection Act 2000

Clause 13 Object of Act

This clause inserts into the objects clause of the TSSPA a new requirement that public funds are invested in a way that promotes socially responsible and environmentally sustainable development.

This is consistent with the way the Investment Advisory Board is required to fulfill its functions under clause 10 new section 129. The amendment recognises that the Act will now do more than simply set aside the money used to meet the Territory's superannuation liabilities and permit the investment of public money in the superannuation account. The amendment expresses the Parliament's objective that not only does the Act ensure that the money once set aside can only be used to meet the Territory's superannuation liabilities but also that whilst the money is invested it should be used in a way that promotes socially responsible and environmentally sustainable development.

Clause 14 and 15 New sections 11 (1A) and 11 (7)

These clauses insert new requirements to ensure that investments made under the TSPPA also comply with any relevant investment direction made by the new Investment Advisory Board (see below notes on clause 10 new section 129D) and the prohibition on investment in defined prohibited investments (see notes on clauses 16 (new section 11B) and 10 (new section 126)).

Clause 16 New sections 11A to 11C

New section 11A - Prioritising investment of amounts in superannuation banking accounts

This new section gives the Investment Advisory Board the power to make guidelines that identify kinds of investments that achieve positive social or environmental outcomes. For example the Investment Advisory Board may determine that investments in renewable energy generally or specific types of renewable energy is appropriate to be deemed a kind of investment that will improve environmental outcomes that should be prioritised. These determinations are disallowable instruments.

The new section also requires that where a relevant guideline has been made investment decisions must, where prudent, prioritise investments of that kind. The prudent person test as it applies to trustee obligations is intended to apply to investment decisions under this section. Where there is no substantive evidence of the potential for a reduced return between competing investment options, that is either option is a prudent investment decision Territory funds must be invested in a defined investment.

There are a number of ways that this requirement could be applied, for example the Directorate could determine specific amounts or classes of investments to be used to give effect to these investment guidelines. Alternatively the Directorate may determine that it is prudent to allocate a set proportion of its private equity investments to a kind of investment proscribed in the guidelines.

Alternatively the obligation could be applied more generally across the portfolio and the Directorate may wish to allocate a proportion of the overall portfolio as a prudent investment to be invested in investments of a kind proscribed in the guideline. The provision is designed to give the decision maker sufficient flexibility to ensure that decisions are prudent in the prevailing market conditions and it may well be that these requirements are adapted over time as experience and expertise is developed.

Investment decisions made under new section 11A are subject to the prohibitions in new section 11B.

New Section 11B – Restrictions on investment of amounts in superannuation banking accounts

This is the equivalent provision to what is inserted into the FMA by clause 6 above. It is intended to have the same application in the context of the TSPPA. The specific prohibitions are articulated in the proposed new section 126 of the FMA as referred to above in clause 10.

New Section 11C – Exercising security holder vote for investment

This new section requires that when the Territory exercises its right to vote as a shareholder because of investments under the TSPPA, the vote must be consistent with any relevant investment direction issued by the Investment Advisory Board relating to voting (see below clause 10 new section 129D).

Clause 17 Dictionary, note 2

This clause inserts ‘Corporations Act’ into the dictionary which in turn refers to the *Legislation Act 2001* which defines ‘Corporations Act’ as the *Corporations Act 2001* (Cwlth).

Clause 18 Dictionary, new definition of investment direction

This clause inserts a signpost definition of ‘investment direction’ to the FMA section 129D.