STANDING COMMITTEE ON PUBLIC ACCOUNTS

# Inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010

DECEMBER 2011

**Report 20**

## Committee membership

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| Ms Caroline Le Couteur MLA | Chair |
| Mr John Hargreaves MLA | Deputy Chair from 5 August 2011 |
| | Member from 20 November 2009 to 5 August 2011 |
| Mr Brendan Smyth MLA | Member from 5 August 2011 |
| | Deputy Chair to 5 August 2011 |
| | Inquiry Chair from 12 October 2010 |
| Ms Joy Burch MLA | Member to 19 November 2009 |

## Secretariat

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| Secretary: | Dr Andréa Cullen |
| Research assistance: | Ms Ellen Groves [with background research on the performance of responsible investments for Chapter 3 and summarising submissions] |
| Administration: | Ms Lydia Chung |

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## Resolution of appointment[1]

The ACT Legislative Assembly appointed the Standing Committee on Public Accounts on 9 December 2008 to:

(1) examine:

    (a) the accounts of the receipts and expenditure of the Australian Capital Territory and its authorities; and

    (b) all reports of the Auditor-General which have been presented to the Assembly;

(2) report to the Assembly any items or matters in those accounts, statements and reports, or any circumstances connected with them, to which the Committee is of the opinion that the attention of the Assembly should be directed;

(3) inquire into any question in connection with the public accounts which is referred to it by the Assembly and to report to the Assembly on that question; and

(4) examine matters relating to economic and business development, small business, tourism, market and regulatory reform, public sector management, taxation and revenue.

[1] ACT Legislative Assembly, *Minutes of Proceedings No. 2*, Tuesday 9 December 2008, pp. 12–13.

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# RECOMMENDATIONS

### RECOMMENDATION 1

2.8 The Committee recommends that the proposed Financial Management (Ethical Investment) Legislation Amendment Bill 2010 not be tabled in the ACT Legislative Assembly, and if tabled, not supported by the ACT Legislative Assembly.

### RECOMMENDATION 2

4.35 The Committee recommends that the ACT Government table in the ACT Legislative Assembly its 2009; 2010 and 2011 United Nations Principles of Responsible Investment annual reporting and assessment survey responses.

### RECOMMENDATION 3

4.36 The Committee recommends that the ACT Government report annually (as an appendix to the Treasury Directorate annual report) on changes it has made to its investment portfolio as a consequence of its signatory status to the United Nations' Principles of Responsible Investment, for example, divestment of shares and changes to investment practices.

### RECOMMENDATION 4

5.21 The Committee recommends that the ACT Government, as an institutional investor should actively pursue a policy of responsible investment with selective use of exclusion-based or negative screening strategies in the context of public policy.

### RECOMMENDATION 5

5.55 The Committee recommends to ensure consistency with recognised investment terminology, and to promote a common understanding, that the ACT Government's 'doing well by doing good' investment policy framework be referred to henceforth as—responsible investment.

### RECOMMENDATION 6

5.61 The Committee recommends that the ACT Government should develop a policy of responsible investment that reflects a principled based approach to this form of investment.

## RECOMMENDATION 7

5.66 The Committee recommends that the implementation and reporting requirements for the proposed responsible investment policy be detailed in the policy. Amongst other things, the policy should:

a) set out norms-based investment criteria for the Territory's investments that are consistent with internationally recognised norms and conventions relevant to ethical investment and responsible investment and the ACT Government's status as a signatory to the United Nations Principles of Responsible Investment

b) in the main, use engagement and integration investment strategies supplemented by the selective use of exclusion-based screening strategies consistent with the ACT Government's articulated public policy context

c) require the ACT Government to instruct its fund managers to invest according to the specified norms-based investment criteria

d) specify an annual reporting and disclosure requirement to ensure transparency with regard to the Territory's investments. Reporting and disclosure requirements should use an "if not, why not?" test,

e) require that funds are not invested in ways that are inconsistent with the core investment objectives of the Territory, and

f) require the ACT Government to comply with the policy and report annually on it to the ACT Legislative Assembly.

## RECOMMENDATION 8

5.76 The Committee recommends that the ACT Government publish a list of the companies in which it holds shares, as part of the annual requirement to report on the proposed responsible investment policy.

## RECOMMENDATION 9

5.77 The Committee recommends that the ACT Government, as part of the proposed responsible investment policy, sponsor or co-sponsor public engagements and shareholder resolutions on matters of concern. The matters of concern should be drawn from the norms-based criteria to be set out in the Government's responsible investment policy. The Government should report on this activity—companies engaged with and the issues involved—as part of the annual requirement to report on the responsible investment policy.

# 1 INTRODUCTION AND CONDUCT OF INQUIRY

## Referral of the inquiry

1.1 The exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010 (the Ethical Investment Bill) was tabled in the Legislative Assembly on 22 September 2010 and referred to the Standing Committee on Public Accounts (the Committee) for inquiry.[2]

1.2 A copy of the exposure draft of the Bill along with the explanatory statement is available at **Appendix A**.

## Terms of reference

1.3 The Committee's terms of reference were to inquire into, and report on, the exposure draft of the Bill as soon as practicable.

## Conduct of the inquiry

### Advertisement

1.4 The Committee called for submissions by advertising in the *Canberra Times* on 3 November 2010 and 2 February 2011, placing a notice on the ACT Legislative Assembly's website, and by writing to the responsible Minister. A wide range of stakeholders was also invited by email and correspondence to participate in the inquiry.

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

## Submissions

1.5 The Committee received seven submissions. The individuals and organisations who lodged submissions are listed at **Appendix B**. Copies of the submissions can be downloaded from the Committee's website.[3]

## Public hearings

1.6 Public hearings were held on: 22 March; 5 July; 7 July; and 2 August 2011. Witnesses who appeared before the Committee are listed at **Appendix C**. The Committee's website contains transcripts of these hearings.[4]

1.7 The Committee met on 23 and 29 November 2011; and 1 December 2011 to discuss the Inquiry Chair's draft report, which was adopted on 1 December 2011.

## How the Committee determined and agreed to progress this inquiry

### 246A Statement to the Legislative Assembly—28 October 2010

1.8 The Committee made a 246A[5] Statement to the ACT Legislative Assembly on 28 October 2010[6] setting out how it had determined and agreed to progress this inquiry.[7] A copy of the Statement is at **Appendix D**.

1.9 In that Statement, the Committee Chair noted that it was on the public record that she held 4.98 per cent of the shares in Australian Ethical Investment and that she had been an executive director of Australian Ethical Investment[8] for 17 years.

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[3] <http://www.parliament.act.gov.au/committees/index1.asp?committee=116&inquiry=991&category=14 >

[4] < http://www.parliament.act.gov.au/committees/index1.asp?committee=116>

[5] Pursuant to Standing Order 246A—Statement and discussion paper.

[6] ACT Legislative Assembly, Minutes of Proceedings No. 83, Wednesday 28 October 2010, p. 1000.

[7] A copy of the 246A Statement is available at: www.hansard.act.gov.au/hansard/2010/week12/5258.htm

[8] Australian Ethical Investment is an ASX listed company based in Canberra that is a retail funds manager specialising in ethical investments.

1.10 Since the first meeting at which the Committee considered the referral, it has carefully reflected on and discussed whether there was any possible (real or perceived) conflict of interest by a Member in the inquiry. As part of this process, the Chair also provided advice, which she had previously sought, to the Committee from the Legislative Assembly's Ethics and Integrity Adviser indicating that, in the Adviser's opinion, no conflict of interest existed.

1.11 The Committee unanimously agreed that no Member had a real conflict of interest. The Committee came to this conclusion because no recommendations of the Committee could directly cause investment changes by the ACT Government or any other entity. The Committee also believed that even if the Legislative Assembly was to fully or partly pass the Financial Management (Ethical Investment) Legislation Amendment Bill 2010 then there was no reason to believe that the Chair would benefit financially from that decision.

1.12 However, to avoid any possible perception of a conflict of interest, the Chair of the Committee offered to relinquish this role for the purposes of this inquiry and the Deputy Chair agreed to chair the inquiry.

1.13 The Committee was also aware of Standing Order 224—Pecuniary interest, which states that: 'A Member may not sit on a committee if that Member has any direct pecuniary interest in the inquiry before such committee'. The Committee also carefully considered the requirements of Standing Order 224 and unanimously resolved that the Chair's participation in the inquiry would not contravene Standing Order 224.

## 246A Statement to the Legislative Assembly—17 August 2011

1.14 After the election of a new deputy chair on 5 August 2011, the Committee made a further 246A Statement[9] to the ACT Legislative Assembly on 17 August 2011[10] and, by leave, moved a motion that the Assembly approve the chairing arrangements for this inquiry. A copy of the Statement is at **Appendix E**.

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[9] A copy of the 246A Statement is available at: http://www.hansard.act.gov.au/hansard/2011/week08/3321.htm

[10] ACT Legislative Assembly, Minutes of Proceedings No. 113, Wednesday 17 August 2011, p. 1430.

1.15 The Committee informed the Assembly that it had resolved for the purposes of progressing its inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010 that, notwithstanding Standing Order 226[11], Mr Brendan Smyth would chair the inquiry.

1.16 The Committee then moved a motion that the Assembly approve the action taken by it in relation to the chairing arrangements for this inquiry. The Assembly agreed to the motion.

### Issue of ethics for Members of the Legislative Assembly

1.17 Given the steps the Committee has taken to progress this inquiry, it begs the question whether any issue of ethics arises for all Members of the Legislative Assembly (MLAs) if the Assembly was to fully, or partly pass, the Financial Management (Ethical Investment) Legislation Amendment Bill 2010. The Assembly Ethics and Integrity Adviser advised:

> In my view, no issue of ethics inherently arises for Assembly Members in considering and, if they wish, passing a Bill that would have the effect of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010.[12]

## Structure of the report

1.18 The Committee has not attempted to produce a definitive work on investment ethics and its terms of reference did not delineate such a task. Instead, the Committee has produced a report that attempts to examine and reflect on several key themes arising in the context of the proposed Bill that became apparent during the course of its inquiry based on the evidence received.

1.19 Submissions to the inquiry, and evidence from witnesses at public hearings, expressed a wide range of views concerning the proposed Bill. Some submitters were fully supportive of the Bill in its current form with suggested amendments dealing, for example, with shareholder advocacy as an additional investment strategy. Others were supportive of the principle

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[11] Standing Order 226—Powers of Deputy Chair

[12] Submission No. 1, November 2010, p. 1.

behind the objective of the Bill but expressed concern with regard to the specified investment strategy and criteria. In contrast, others were not supportive of the Bill and highlighted the additional costs to the Territory if the Bill was implemented in its current form together with a range of information and administrative challenges it would create for the management of the Territory's investment portfolio. A number of submitters commented on the challenging nature of this form of investment in terms of consistent definitions and the subjective nature of investment criteria and thresholds. Another submitter emphasised the important role the United Nations Principles of Responsible Investment are making in terms of a principled based approach for investors to 'do well by doing good'. A number of submitters also noted that the ACT Government was the first government in Australia to become a signatory to these principles and that this commitment should not be understated.

1.20 The Committee's report is divided into three parts and covers the following main topics:

***Part 1 – Context to the inquiry***

- Chapter 1—Introduction and conduct of the inquiry
- Chapter 2—The proposed Bill

***Part 2 – Government as institutional investors***

- Chapter 3—'Doing well by doing good' investment
- Chapter 4—The ACT Government as an investor
- Chapter 5—A policy based approach for 'doing well by doing good' investment

***Part 3 – Summary and conclusions***

- Chapter 6—Committee conclusions

## Acknowledgements

1.21 The Committee thanks the current Treasurer, Mr Andrew Barr MLA, the former Treasurer, Ms Katy Gallagher MLA, and Treasury Directorate officials, who assisted the Committee during the course of its inquiry. The Committee also acknowledges and thanks all those who contributed to its inquiry by making submissions, providing additional information and appearing before it to give evidence.

# 2 THE PROPOSED BILL

2.1 The proposed Bill will amend the *Financial Management Act 1996* and the *Territory Superannuation Provision Protection Act 2000* to provide for ethical investment strategies that promote socially responsible investment. The main objectives of the Bill are to prescribe the standards and priorities for the investment of public funds by the ACT Government.[13]

2.2 The Bill proposes amendments to the *Financial Management Act 1996*—investment of certain public funds to be subject to restrictions—limiting investments to entities (as defined by the Bill) where more than five per cent of those entities' revenue is attributable to a specified good or activity (as defined in the Bill).

2.3 The Bill also proposes amendments to the *Territory Superannuation Provision Protection Account 2000*—investment of amounts in superannuation banking accounts to be subject to restrictions—limiting investments to entities (as defined by the Bill) where more than five per cent of those entities' revenue is attributable to a specified good or activity (as defined in the Bill). It also proposes amendments related to prioritising investment amounts in superannuation banking accounts. Under this new section, in deciding how to invest an amount in a superannuation banking account, the Director-General must, if satisfied it is prudent, give priority to investing in a defined ethical investment (as defined in the Bill) over another investment.

2.4 In responding to the proposed Bill, a submission from the ACT Legislative Assembly Ethics and Integrity Adviser to the Committee stated:

> Legislation that would prevent or limit investment by the Executive or other public bodies of public moneys in certain forms of investment, or that would promote investment in other forms, is clearly within the legislative competence of the Assembly. Whether the power to do so should be exercised calls for a balancing of what may be perceived to be competing priorities—for example, between a policy favouring an optimum financial return on investment on the

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[13] Ms Meredith Hunter MLA, Explanatory Statement— Financial Management (Ethical Investment) Legislation Amendment Bill 2010, 22 September 2010; Exposure draft— Financial Management (Ethical Investment) Legislation Amendment Bill 2010, September 2010.

> one hand, and a policy of not supporting an industry that manufactures products injurious to health or the environment on the other. The resolution of such balances is a matter of policy rather than ethics.
>
> However, there is an ethics-related issue raised by the Bill—whether or not a Bill to that proposed effect should be passed in terms proposed.
>
> In my view it should not. I consider that it would be wrong, misleading and inappropriate to refer to the proposed prohibited investments in terms suggesting that they are not ethical, or to the proposed priority-if-prudent investments in terms that suggest that other investments would not be ethical. Each of the activities encompassed by *[sic]* referred to by the Bill is lawful. Like all lawful activities, they can be conducted ethically or unethically. None of them is inherently unethical, or more ethical than others. To suggest otherwise distorts the concept of ethics and is likely to confuse public understanding of ethical concepts. For example, the provision allowing investment in prohibited investments below a certain threshold appears to suggest that it is permissible to be a little bit unethical. I consider that, as a matter of public policy, that concept should not be countenanced.
>
> In my view, if the Assembly wished to achieve the effect of the Bill, it would be preferable to emend its terms by deleting all use of the word "ethical" and substituting alternative terminology such as "socially sensitive" that more accurately reflects the policy issues that are sought to be balanced by the Bill.[14]

2.5 It is not possible to legislate for something to be 'ethical'. Ethics are an individual response to moral issues. Consequently, it is not feasible for any legislation to define an ethical position for a community. The Committee notes that there is no definition of 'ethical' in the Bill. It is self-evident, therefore, that it is not possible to provide a definition of 'ethical' in such a Bill because of the partisan nature of what is meant by 'ethical'.

2.6 The significant concern that is raised by the inability to define 'ethics' or 'ethical' is that the objectives underlying the Bill could be 'captured' by a specific interest group to further its own political objectives. As this Bill has been drafted by the Greens, it is reasonable to hypothesise that the passing of this Bill in its current form will simply provide that political party with a platform to pursue its own political ideology.

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[14] Submission No. 1, November 2010, pp. 1–2.

2.7 In view of these most serious and fundamental concerns about the nature of this Bill, the Committee does not support the Bill.

### RECOMMENDATION 1

2.8 **The Committee recommends that the proposed Financial Management (Ethical Investment) Legislation Amendment Bill 2010 not be tabled in the ACT Legislative Assembly, and if tabled, not supported by the ACT Legislative Assembly.**

2.9 One member of the Committee took the view that the ACT Government has public policy objectives, many of which have broad community agreement. The Committee member put forward the view that these public policy objectives could inform the ACT Government's investment policy. The Committee member felt that is the essence of the proposed Bill.

# 3 DOING WELL BY DOING GOOD INVESTMENT

*Some people (such as investors) are guided by a sense of moral duty, in that not only is the maximisation of shareholder wealth an important goal, but also the maximisation of shareholder welfare (or a concern for the community).*[15]

3.1 Notwithstanding the Committee's position as outlined in chapter two of this report, in the spirit of tri partisanship, the Committee has duly considered an alternative approach to strengthen the Government's investment framework with regard to the practice of 'doing well by doing good' investment. This approach, along with a number of proposed recommendations, as a way forward, is framed within a policy context and is detailed at chapter five.

3.2 However, to inform the basis for the alternative approach as detailed in chapter five, the Committee has duly considered: (i) the historical and theoretical context for a form of alternative investment that considers things other than maximising return when making investment decisions; and (ii) the role of governments in this form of investment practice. Each of these matters are detailed and discussed in chapter three and four respectively.

## Doing well by doing good investment theory—an historical and international context

3.3 Important ideas and indeed important truths must be grounded in historical context and cannot be grasped in a vacuum.[16]

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[15] Etzioni, A. (1988) *The Moral Dimensions: Toward a New Economics*, The Free Press, New York.

[16] Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT, p. 79.

3.4 Decisions and actions of the present must always be considered in a historical context. It is important from the outset of this inquiry to frame the practice of 'doing well by doing good' investment in a historical context together with establishing a common understanding of the various definitions and terms that are commonly associated with the practice. This chapter attempts to do this as an important prerequisite for considering an alternative approach to strengthen the Government's investment framework.

3.5 The concept of 'doing good' with your investments whilst 'doing well' financially[17] is not new and its beginnings can be traced back to the late seventeenth century.[18] As an investment strategy, ethical or socially responsible investment, in addition to the traditional investment motives of maximising returns and minimising risk, also offers the opportunity to balance financial return with ethical, environmental and social concerns.

3.6 Its emergence as a distinctive practice is attributed to religious groups that consciously made investment decisions based on their moral principles rather than just financial returns. Spanning from the seventeenth century to today, 'religious investors have actively avoided investments that profit from products designed to kill fellow human beings'.[19]

3.7 The Quakers are often credited with playing a significant leadership role in its emergence as an investment practice by their avoidance of investments that involved the slave trade. In 1783, the Quakers presented to the British Parliament the first significant anti-slavery petition that eventually resulted in the abolition of the slave trade. This was considered a defining contribution to the development of investing with a conscience.

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[17] Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT.

[18] Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT; Ghahramani, S. (2011) Governments, Financial Markets, And International Human Rights: The State's Role as a Shareholder, *Yale Journal of International Affairs*, Winter, pp. 85–95.

[19] Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT, p. 79.

Furthermore, the Quakers were also active, early in the nineteenth century, in the area of labour practices. Through their role with the British companies—Cadbury, Fry and Rowntree—they lobbied to create better working conditions for Victorian workers.[20]

3.8 The emergence of 'doing well by doing good' investment as a practice can be mapped in two main iterations or waves. In its contemporary form, its first iteration can be traced back to the early nineteenth century where investors used their religious views to guide investment decisions to avoid (negative screening), what were considered 'sinful activities' or 'sin' stocks such as alcohol, tobacco, armaments and gambling-related companies or industries.[21] Avoidance of 'sinful activities' was supplemented in the 1940s, in the main by governments and unions, avoiding investment in companies engaged in unfair labour practices.[22]

**First wave or iteration**

3.9 Initially, the strategy used by the early adopters was predominantly negative screening which transitioned, for example in the United Kingdom (UK), to a positive screening approach. In practice, this signalled a shift from making investment decisions to avoid 'sinful activities' to investing in companies whose activities and products were considered to positively benefit the community.[23]

3.10 The prohibitions and social concerns that formed the basis of the moral stance taken by the religious groups early in the nineteenth century were not only influential at the time but are still considered to be:

> ...the most predominant aspect of modern day ethical and socially responsible investing practice. Negative and positive screens are among the major

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20 Hancock, J. (2002) *Ethical Money: How to invest in sustainable enterprises and avoid the polluters and exploiters*, Kogan Page, London.

21 Ghahramani, S. (2011) Governments, Financial Markets, And International Human Rights: The State's Role as a Shareholder, *Yale Journal of International Affairs*, Winter, pp. 85–95.

22 Hill, R.P. et al. (2007) Corporate Social Responsibility and Socially Responsible Investing: A Global Perspective, *Journal of Business Ethics,* **70**, 2, pp. 165-174.

23 Sparkes, R. (1995) *The Ethical Investor*, Harper Collins, London.

> strategies promoted and the majority of funds in Australia still specifically avoid investment in tobacco, alcohol and armaments.[24]

3.11 However, whilst the stance taken by religious groups was distinctively informed by religious beliefs, some suggest that the fund managers of today 'appear to use the same criteria without any indication of the substantive or procedural moral principles underlying their approach'.[25]

**Second wave or iteration**

3.12 The second iteration or wave of 'doing well by doing good' investment is considered to have started in the late 1960s to early 1970s. It gained momentum through the combination of the civil liberty and civil right campaigns of the time coupled with the passionate political climate of that era.

3.13 The strategies adopted by investors in the 1970s expanded to major social movements, encompassing:

> ...the Vietnam War, environmental degradation, urban conflict, and apartheid caused a rapid expansion of values-based investing efforts.[26]

3.14 More importantly, the second iteration typified a shift in the focus of 'doing well by doing good' investment from a practice:

> ...based predominantly on religious prohibitions, to a broader and more social agenda growing out of concerns centred on the Vietnam War...once again religious institutions were at the fore, they were joined ...by academic institutions concerned about profiting from companies engaged in the provision of war supplies of armaments and chemicals such as Napalm and Agent Orange.[27]

3.15 Whilst the first wave predominantly utilised the strategies of negative and positive screening, the second wave gave rise to shareholder activism as a viable strategy for investing with conscience. The difference between each wave was a shift from a passive avoidance strategy to more proactive

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[24] Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT, p. 81.

[25] *Ibid.*

[26] Hill, R.P. et al. (2007) Corporate Social Responsibility and Socially Responsible Investing: A Global Perspective, *Journal of Business Ethics,* **70**, 2, pp. 165-174.

[27] Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT, p. 82.

engagement focused on changing the values and/or behaviour of investment targets.[28]

3.16 Shareholder resolutions were a key instrument used to achieve this end. A defining shareholder resolution during this time was the 1969 Dow Chemical's shareholder resolution that challenged the company's production of Napalm. This was followed shortly after by Ralph Nader's resolutions to the 1970 General Motors' annual general meeting raising uneasiness with the treatment of 'minorities, workers and consumers'.[29]

3.17 The momentum of the shareholder activist movement closely associated with the second wave brought about the establishment of the Interfaith Centre on Corporate Responsibility 'to bring the Christian voice to the boardrooms of America in 1973' as well as an increase in investment intermediaries specifically focused on responding to the need for 'doing well by doing good' investment opportunities.[30]

3.18 In its contemporary form, 'doing well by doing good' investment decisions continue to be based on similar practices to those utilised by the early adopters, in particular:

> ...human rights violations, labour abuses, fair trade, climate change and environmental concerns, and domestic and international tensions.[31]

3.19 Its proponents claim that 'doing well by doing good' investment can permit an investor to be able to 'achieve financially balanced investment portfolios while maintaining a commitment to certain personal or global values'[32] along with 'unprecedented opportunities to create a sustainable social and

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28 Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT.

29 Sparkes, R. (1995) *The Ethical Investor*, Harper Collins, London, p. 115; Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT.

30 *Ibid.*

31 Ghahramani, S. (2011) Governments, Financial Markets, And International Human Rights: The State's Role as a Shareholder, *Yale Journal of International Affairs*, Winter, p. 87.

32 *Ibid.*

economic future'.[33]

3.20 Others suggest, as a form of investment, it is 'a ready market for investment managers and investment targets seeking to gain market share in an increasingly lucrative investment market niche'.[34]

3.21 Others also suggest that mainstream companies in the global marketplace are increasingly considering environmental, social and governance issues as core business. For example, BlackRock—the world's biggest fund manager is actively pursuing a strategy of responsible investment with the recent appointment of a former Regnan Director as its head of corporate governance and responsible investment. The global influence BlackRock, as a mainstream investor, can have in terms of responsible investment via engagement and integration strategies is significant given it has $US3.6 trillion ($AUD3.8 trillion) in funds under management. Its sheer size translates to significant potential for influence on boards in multinationals via its shareholdings in companies such as BHP Billiton, Rio Tinto and News Corporation.[35]

## The Australian context

3.22 As highlighted in the previous section, the development of the 'doing well by doing good' investment concept can be mapped in two iterations or waves. Notwithstanding this, it is noted that there are differences between countries with regard to the uptake of the concept, the types of investment strategies and variation in focus of approaches that are used to give effect to this form of investment. Generally, this is attributable to differences in the type and nature of existing infrastructure in each country's respective investment industry.[36] For example, variation in approaches across countries includes,

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[33] Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT, p. 14.

[34] *Ibid.*

[35] Editorial. (2011) *Australian Financial Review*, 7 October.

[36] George, A., Edgerton, N. and Berry, T. (2005) *Mainstreaming Socially Responsible Investment (SRI): A role for government?*, Institute of Sustainable Futures—University of Technology, Sydney, November, pp. 1–47; Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory*

the United States (US) has focused on:

> ...sin stocks such as tobacco but with a growing interest in environment, community and workplace issues, the U.K. with a similar approach but with an increasing emphasis on genetically modified plants and animals, Canada with a less exclusionary approach focusing human rights, labour and community involvement; and Germany with a focus on environmental concerns.[37]

3.23 Views vary widely on the speed of the Australian uptake of the concept of 'doing well by doing good' investment compared with the US and the UK. A reluctance to support this form of investment has been attributed to:

> ...the dominance of the mining and energy sector in the domestic sharemarket until recent years, and the belief amongst many investors that returns in such investments will be lower. A consistent comment has been that there is a lack of high quality products in this area in Australia.[38]

3.24 The uptake of 'doing well by doing good' investment in Australia, in the first instance was focused on environment issues with a dominance of the best of sector approach as an investment strategy. The best of sector approach was popular because of Australia's significant resources sector.[39] Today, in the case of institutional investors, the initial focus on environmental issues has expanded to also include: human rights, weapons, gambling, uranium, corporate governance, animal welfare, citizenship, tobacco, work practices and alcohol.[40]

3.25 Some suggest that 'doing well by doing good' investment began in Australia in 1981 with the first meeting of The Other Economic Summit (TOES)—a counter summit to the annual G7. Attendees at the TOES included

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*of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT, pp. 69–72.

37 Rose, J. (2001) *Ethical and Active Shareholding—An Australian Investors Guide*, Wrightbooks, Melbourne, p. 23.

38 Watmore, M. and Bradley, L. (2001) The Rothschild Report—Ethically and socially responsible investing...the next wave?, *Rothschild Australia*, April, p. 3.

39 Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT, pp. 69–72.

40 Watmore, M. and Bradley, L. (2001) The Rothschild Report—Ethically and socially responsible investing...the next wave?, *Rothschild Australia*, April, p. 5.

economists, greens and community activists.[41] The driver for the uptake of 'doing well by doing good' investment in the late 1980's has been attributed to the 'corporate excesses of that decade'.[42] Furthermore, its uptake in Australia has been shaped by the existing investment industry framework. In the main, investment activity in Australia is shaped and directed by the industry's regulatory framework more than by:

> ...external stakeholder pressure. Furthermore, compared to other countries, Australian business traditionally responds to threats of punitive action more so than to incentives when it comes to changing their behaviour...As such, the nature of government involvement has so far been typified more by compliance-based legislation than by incentives that reward positive corporate behaviour.[43]

3.26 Since its uptake as an investment practice in the early 1980s, demand for 'doing well by doing good' investment opportunities in Australia has grown with both the retail and institutional sectors of the financial services market now well versed in the concept. There has also been a transitioning from investors pursuing it as a form of investment to mainstream companies now incorporating it as part of core business.

3.27 An example of a mainstream investor pursuing a responsible investment strategy in Australia is AMP Capital—Australia's largest manager of superannuation savings. AMP Capital was recently reported as having transitioned its responsible investment strategies from shareholder activism via the media to an approach of making its concerns known in private. This evolution in practice was on the basis that it was more effective and constructive to work in this way to pursue responsible investment.[44]

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[41] The Other Economic Summit. (1985). Bonn Economic Summit: A Draft Agenda for Economic Recovery and World Development, *Community Development Journal*, 20. 4, pp. 309–311; Lee, T. (1996) *Ethical investment in Australia: A handbook for the concerned investor*, Ethinvest, Melbourne.

[42] Lee, T. (1996) *Ethical investment in Australia: A handbook for the concerned investor*, Ethinvest, Melbourne, p. 4.

[43] George, A., Edgerton, N. and Berry, T. (2005) *Mainstreaming Socially Responsible Investment (SRI): A role for government?*, Institute of Sustainable Futures—University of Technology, Sydney, November, p. 10.

[44] Grigg, A. (2011) AMP reborn as the pacifist activist, *Australian Financial Review*, 7 October 2011.

## Doing well by doing good investment—some definitions

3.28 According to the literature, 'doing well by doing good' investment is an ever-evolving concept with a diverse range of nomenclature and its investment related decisions can 'take on many forms and foci'.[45] In an attempt to define the terms associated with its contemporary practice, the previous section mapped its development in two iterations or waves.

3.29 The terms commonly associated with its contemporary practice are ethical investment (EI) and socially responsible investment (SRI). The terms are often used interchangeably in the literature and are also used in current practice to refer to a form of alternative investment that considers things other than maximising return when making investment decisions.[46]

3.30 As an investment practice, the concept of 'doing well by doing good' investment appears to have evolved in two paradigms or waves which are defined not only by different nomenclature but also the form and foci of the types of investments associated with each paradigm. Principally, the defining attribute between the two waves is a transitioning in the overarching objective and outcomes sought by this form of investment—that

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[45] Steurer, R., Margula, S. and Martinuzzi, A. (2008) *Socially Responsible Investment in EU Member States: Overview of government initiatives and SRI experts' expectations towards governments—Final Report to the EU High-Level Group on CSR*, European Commission, Research Institute for Managing Sustainability, Vienna University, April, p. 7; Ghahramani, S. (2011) Governments, Financial Markets, And International Human Rights: The State's Role as a Shareholder, *Yale Journal of International Affairs*, Winter, pp. 85–95; Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT; George, A., Edgerton, N. and Berry, T. (2005) *Mainstreaming Socially Responsible Investment (SRI): A role for government?*, Institute of Sustainable Futures—University of Technology, Sydney, November, pp. 1–47.

[46] Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT; Ghahramani, S. (2011) Governments, Financial Markets, And International Human Rights: The State's Role as a Shareholder, *Yale Journal of International Affairs*, Winter, pp. 85–95;Steurer, R., Margula, S. and Martinuzzi, A. (2008) *Socially Responsible Investment in EU Member States: Overview of government initiatives and SRI experts' expectations towards governments—Final Report to the EU High-Level Group on CSR*, European Commission, Research Institute for Managing Sustainability, Vienna University, April.

is, from primarily a financial tool to protest against corporations profiting from specified activities via screening to a more proactive orientation that seeks to create change through engagement and integration.[47]

3.31 It should also be noted that the second wave increasingly emphasises or uses the term 'socially responsible' as opposed to 'ethical' investing. Some in the literature suggest that this reflects a 'diminution of the aims and objectives of this form of investing'. In an article in *Ethical Investor*, Robert Rosen (2000) suggested that use of the term 'socially responsible' investing implied a departure from the values based focus of 'ethical' investing and was damaging to the debate. Rosen advocated that 'moving away from values based language would threaten the fundamental essence of ethical investment'. However, others who consider 'socially responsible' to be a less stringent term than 'ethical' are of the view that it is an attempt to make the debate more acceptable to those wishing to avoid the moral implications associated with the term 'ethical'.[48]

3.32 A summary of the evolution of 'doing well by doing good' investment is set out in the table below. As noted previously, as an investment concept it can be mapped in two waves. Notwithstanding this, it is noted that there are differences between countries with regard to the uptake of the concept, the types of investment strategies and variation in focus of approaches that are used to give effect to this form of investment.

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[47] Ghahramani, S. (2011) Governments, Financial Markets, And International Human Rights: The State's Role as a Shareholder, *Yale Journal of International Affairs*, Winter, pp. 85–95; Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics*, A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT; George, A., Edgerton, N. and Berry, T. (2005) *Mainstreaming Socially Responsible Investment (SRI): A role for government?*, Institute of Sustainable Futures—University of Technology, Sydney, November, pp. 1–47.

[48] Rosen, R. (2000) The Ethical Investment Olympics: How to Clear the Bar, *Ethical Investor;* Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT.

**Table 2.1—Summary of the evolution of 'doing well by doing good' investment concept**

| Iteration/wave /paradigm | Commenced | Description | Investment strategies |
|---|---|---|---|
| 1st iteration/wave /paradigm<br><br>**Ethical investment** | From early 19th century onwards | Can be traced back to the early nineteenth century where investors used their religious views to guide investment decisions to avoid, (negative screening) what were considered 'sinful activities' or 'sin' stocks such as alcohol, tobacco, armaments and gambling-related companies or industries.[49] Avoidance of 'sinful activities' were supplemented in the 1940s, in the main by governments and unions, avoiding investment in companies engaged in unfair labour practices.[50] | Initially, the strategy used by the early adopters was predominantly negative screening which transitioned, in some jurisdictions, to a positive screening approach. In practice, this signalled a shift from making investment decisions to avoid 'sinful activities' to investing in companies whose activities and products were considered to positively benefit the community. |
| 2nd iteration/wave /paradigm<br><br>**Socially responsible investment** | From late 1960s to 1970s onwards | The second iteration or wave of ethical or socially responsible investment is considered to have started in the late 1960s to early 1970s. It gained momentum through the combination of the civil liberty and civil right campaigns of the time coupled with the passionate political climate of the time.<br><br>Some suggest that this wave appears to signal a shift from a values based language associated with the essence of ethical investment to a less stringent terminology, in an attempt to make this form of investment more acceptable to those wishing to avoid the moral implications of use of the term 'ethical' | The second wave gave rise to shareholder activism as a viable strategy for investing with conscience. This marked a shift from a passive avoidance strategy to more proactive engagement focused on changing the values and or behaviour of investment targets. Shareholder resolutions were a key instrument used, by the early adopters, to achieve this end. This has transitioned to also include the incorporation of environmental, social and governance (ESG) practices into the mainstream global investment marketplace. |

3.33 Issues surrounding nomenclature were also raised during the inquiry. A submission commented:

> In my view, if the Assembly wished to achieve the objective of the Bill, it would be preferable to amend its terms by deleting all use of the word "ethical" and substituting alternative terminology such as "socially sensitive" that more accurately reflects the policy issues that are sought to be balanced by the Bill.[51]

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49 Ghahramani, S. (2011) Governments, Financial Markets, And International Human Rights: The State's Role as a Shareholder, *Yale Journal of International Affairs*, Winter, pp. 85–95.

50 Hill, R.P. et al. (2007) Corporate Social Responsibility and Socially Responsible Investing: A Global Perspective, *Journal of Business Ethics*, **70**, 2, pp. 165-174.

51 Submission No. 1, November 2010, pp. 1–2.

3.34 The Committee sought the views of a witness with regard to this statement and was told:

> There is an intellectual arrogance about that… That is saying, "I'm going to change well-known nomenclature, because I don't like it." It is not that there is not some sense in his dislike; it is just that it is too late. It is called "ethical investment". Sometimes it is called "SRI", sustainable and responsible investment. If you say you have got socially sensitive investment, nobody is going to know what you are talking about.[52]

## Determination of investment criteria

3.35 Investment criteria are determined by the investor. The type of criteria specified will be based on: (i) values—a single value or values associated with either a religious or other belief, such as environmental and/or social values; and (ii) norms— compliance with international standards, norms, conventions and treaties, for example, the United Nations (UN), Organisation for Economic Cooperation and Development (OECD), World Bank, International Monetary Fund (IMF), International Labour Organization (ILO), Universal Declaration of Human Rights 1948, International Covenant on Civil and Political Rights, Convention on the Rights of the Child, Environmental Treaties covering agriculture, biodiversity, climate change, conservation, environment, fisheries and trade. An investor may specify investment criteria that reflect either values or norms or a combination of both.

3.36 The determination of investment criteria is not a neutral activity and is very much a subjective process an investor uses to align their investments with designated values or beliefs. For example, in the case of screening as an investment strategy:

> Some screening comes from a set of values. Some screening is based on norms. There is a distinction usually made between values and norms screening. So values might be the screening that a religious organisation uses. Norms refers to, for example, the labour norms of the International Labour Organisation, or something like that.[53]

3.37 Furthermore, the type of investor—retail or individual, institutional or government as an institutional investor—will also influence the determination of investment criteria.

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[52] Mr Howard Pender, *Transcript of evidence*, 22 March 2011, p. 16.

[53] *Ibid.*, p. 1.

3.38 In the case of retail or individual investors—in relation to investment criteria:

> …everybody potentially has different versions of ethics. If you are rich enough, you can indulge them, if you want to call it that, or pursue them. Sometimes they are whims and sometimes they reflect moral values that lots of people would agree with. I see both.[54]

3.39 In the case of institutional investors, investment criteria will be guided by an organisation's charter or purpose. For example, the Committee was told:

> …Australian Ethical has a particular set of principles which are set out in our charter and incorporated into all of our legal documents. But they are designed for a particular pool of people. Foundations, not-for-profits, will often pursue ethical investment consistent with their particular raison d'être. In the US, a lot of hospitals have foundations and they will almost always have, in the investment of those moneys, strong health-associated ethical investment criteria. Usually there is some screening; often there is some advocacy obligation as well, into the legal documents, typically. Move Calvary to the US. It has a large endowment. It would have Catholic and health-related ethical investment prescription in its investment documents. And it would pursue those.[55]

3.40 In the case of governments, as institutional investors, norms-based investment criteria are considered more appropriate and, in evidence, the Norwegian government pension fund was suggested as useful guidance for such investment criteria. In evidence, the Committee was further told:

> As far as examples of government bodies are concerned, like the ACT government, I think the Norwegian government pension fund is the best place to look for an example. They have some ethical exclusion but they also have some of this norms-based screening which I think is a bit more appropriate in a government situation.[56]

3.41 In choosing which norms to consider for a screening process, the investor is making a judgement of the importance of the issue and the norms relating to it. These norms could be chosen to relate to the Government's public policy objectives.

## Types of investment strategies

3.42 How an investor gives practical effect to a desire to 'do well by doing good' can take a number of forms. A summary of the various investment strategies or instruments an investor can utilise is set out in the table below.

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[54] Mr Howard Pender, *Transcript of evidence*, 22 March 2011, p. 10.

[55] *Ibid.*

[56] *Ibid.*, p. 11.

**Table 2.2—Overview of 'doing well by doing good' investment strategies/instruments/approaches**[57]

| Type of investment | | | | Strategy | Description |
|---|---|---|---|---|---|
| SOCIALLY RESPONSIBLE INVESTMENT (SRI) or SUSTAINABLE AND RESPONSIBLE INVESTMENT (SRI) | ETHICAL INVESTMENT (EI) | Screened investment | Negative | **Negative screening/simple exclusions** | Investors/fund managers exclude, or screen out, particular investments based on output, industry sector or social and/or environmental performance that are at odds with an investor's specified investment criteria (based on a value or values associated with either a religious or other belief, such as environmental and/or social values).<br>**Outputs**—can include: alcohol, tobacco and armaments.<br>**Industry sectors**—can include: aviation, gambling and nuclear energy.<br>**Social and/or environmental performance**—can include: human rights violations, bribery or corruption, unfair labour practices. |
| | | | | **Ethical exclusions** | Investors/fund managers exclude companies based on a number of negative criteria and/or filters (as opposed to a single output/industry/performance criterion such as tobacco or bribery or corruption). |
| | | | Positive | **Positive screening** | Investors/fund managers select and invest in companies with a commitment to responsible business practices, produce positive products and/or services. Includes: best of best; best-in-class; and pioneer screening. |
| | | | | Best-of-best | Investors/fund managers select companies and industries that make positive contributions to society and/ or the environment, based on criteria specified by the investor. Permits an investor to maintain a 'clean' portfolio. |
| | | | | Best-in-class | Investors/fund managers select companies leading their industry in reforms towards environmental, social, labour and community standards and does not exclude industries classed as 'dirty' such as logging or mining. Has two advantages over best of best approach—(i) allows for a more diversified portfolio, lowering financial risk and creates an incentive for companies to strive towards responsible practices independent of sector norms; and (ii) allows for investors to directly impact company behaviour in all industries through shareholder engagement. |
| | | | | Pioneer screening/ Thematic investment propositions | Investors/fund managers invest in selected companies that represent industries of the future, i.e., play a key role in the transition to a more sustainable future, for example, a low carbon economy, renewable energy, waste management, environmental technology. |
| | | | Norms | **Norms based screening** | Conducts positive or negative screenings of companies based on compliance with international standards, norms, conventions, treaties, for example, by the UN, OECD, World Bank, IMF, the ILO. |
| | | Community Investing | | **Community financing/investing (also referred to as Socially Directed Investing or Cause-Based Investing)** | Broad underlying principle of this form of investment is to support a particular cause or activity through financing it by investment. Investors in some cases may accept a lower or zero financial return to achieve a social dividend from an investment. Furthermore, this form of investment, unlike a donation, requires that, at a minimum, the original value of the investment must be returned to the investor. |
| | RESPONSIBLE INVESTMENT (RI) | | | **Engagement (also referred to as shareholder activism)** | Investors make use of their influence as shareholders.<br>Attempts to raise awareness for environmental, social and governance (ESG) issues with companies, in the main via dialogue between investors and companies on issues of concern—via shareholder advocacy. This can include: (i) shareholder voting practices; (ii) dialogue with directors and management and divestment (as a last resort). The effectiveness of engagement via dialogue tends to be limited by the proportion of capital the investor owns. Better suited to institutional investors. Engagement is usually practiced as a supplement to traditional financial selection—either 'above' or in addition to. |
| | | | | **Integration** | Includes social/environmental/ethical considerations in traditional or mainstream financial analysis. The ultimate approach that fully integrates SRI into company analyses. Goes beyond ESG issues and applies a holistic approach to responsible investment across all asset classes. |

57 George, A., Edgerton, N. and Berry, T. (2005) *Mainstreaming Socially Responsible Investment (SRI): A role for government?*, Institute of Sustainable Futures—University of Technology, Sydney, November, pp. 1–47;

3.43 In some cases, an investor's specified investment criteria may mandate a particular investment strategy. The strategies employed by investors will vary depending on the type of investor and across different industries, outputs or performance based criteria.

## Dilemmas of doing well by doing good investment

3.44 There are a number of dilemmas associated with the concept of 'doing well by doing good' investment that were highlighted throughout the inquiry. In the main, they were concerned with: (i) definitions—what does ethical mean? and more importantly how this influences an investor's investment criteria; (ii) how investment criteria are translated into practice and issues about whether the application of them can practically give effect to the desired outcomes; and (iii) the point at where these types of investment decisions should stop, i.e., where does an investor draw the line? Discussion related to each of these points is summarised below.

### Definitions—what does investing ethically mean?

3.45 Investing ethically is not a value neutral activity and the word ethical is:

> …loaded with cultural assumptions, tainted by competing morals and rent by conflicting goals that it is conceivably possible to attack the same stock for being a saint or a sinner.[58]

3.46 An article in Australia's *Ethical Investor* magazine captures some of the definitional issues often raised in the context of this form of investing:

> ...there is no single, accepted body of ethics...ethical funds are self defined*...[and further that it is not possible to determine if the investments of so called Ethical Investment funds are]*...purer than the generality of investments...because ethics

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[57] (contd.) Steurer, R., Margula, S. and Martinuzzi, A. (2008) *Socially Responsible Investment in EU Member States: Overview of government initiatives and SRI experts' expectations towards governments—Final Report to the EU High-Level Group on CSR,* European Commission, Research Institute for Managing Sustainability, Vienna University, April, p.7; Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT; Mr Howard Pender, *Transcript of evidence*, 22 March 2011; Ms Louise O'Halloran, *Transcript of evidence*, 7 July 2011; Submission No. 2a—March 2011; Submission No. 6—March 2011; Wagg, O. (2010) Investors ignore global megatrends at their peril, *Ethical investor*.

[58] Hughes, D. (2011) Dilemmas of being ethical, *Australian Financial Review*, 27 April.

> are multifarious and consequently ethical investments...*[and]*...almost any legal business activity will be regarded as ethical by a sufficient group of investors to be included in an ethical fund.[59]

3.47 A submission to the inquiry highlighted an ethics related issue raised by the proposed Bill, that is:

> ...whether or not a Bill to that proposed effect should be passed in the terms proposed.
>
> In my view it should not. I consider that it would be wrong, misleading and inappropriate to refer to the proposed prohibited investments in terms suggesting that they are not ethical, or to the proposed priority-if-prudent investments in terms that suggest that other investments would not be ethical. Each of the activities...referred to by the Bill is lawful. Like all lawful activities, they can be conducted ethically or unethically.[60]

3.48 This viewpoint begs the question—how do you determine what is ethical and what is not?—noting that there is no definition of ethical in the proposed Bill. Furthermore, the viewpoint expressed as above is saying that the prohibited activities listed in the Bill are lawful and that it would be 'wrong, misleading and inappropriate' to refer to them as unethical.[61]

3.49 In response, the Executive Director of Australian Ethical Investment Limited commented:

> I can see his point...but I do not agree with it. The problem is that his point might have been accurate if it was made 40 years ago, but ethical investment is now a well-known term of art, and it does have a meaning, and what is in this bill does reflect that meaning. It is really too late for him or you to try and say, "We're just not going to agree with the going nomenclature." He has got a point. But it is like saying "I don't like some particular term because it's not the right term" when everybody is using that term. You might be right, but it is a bit not to the point.[62]

3.50 Research by Lewis (2002) indicates that in a practical sense much of what investors do is motivated by what they want to do, not what they ought to

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[59] Hoggett, J. and Nathan, M. (2002) Ethical Investment—Deconstructing the myth, *Review—Institute of Public Affairs*, 3, 54, September; Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT, p. 6; Hoggett, J. and Nathan, M. (2002) Ethical Investment—Deconstructing the myth, *Review—Institute of Public Affairs*, 3, 54, September.

[60] Submission No. 1, November 2010.

[61] *Transcript of evidence*, 22 March 2011, p. 14.

[62] Mr Howard Pender, *Transcript of evidence*, 22 March 2011, p. 14.

do. Ethical reasoning, however, requires that we consider what we ought to do whether or not we want to, or it is practical to, do it. The fact that an action is not practical or is difficult does not mean that it is acceptable to do something else that may not be morally good or right. Neither can we consider the accidental or unintended outcome of investing to be a factor in determining its ethical status. A particular investment is ethical or unethical because of what we ought or ought not to do.[63]

3.51 In summary, how a client, whether that be an individual or an institutional investor, decides to give practical effect to a decision to invest ethically, is very much a subjective process. It is such a process:

> Because there is no centrally agreed definition of what is ethical and what is not. What you can achieve is consensus around what sorts of things are particularly offensive and what sorts of things are not. But it is particularly difficult to come up with a central definition of what is ethical that would be agreeable to all people.[64]

3.52 In the case of the ACT Government, as an institutional investor, it can express its policy objectives through the criteria it applies to its investments.

### Translating investment criteria into practice—some dilemmas

3.53 Giving practical effect to investment criteria also raises some dilemmas. These can arise in relation to the selection of stocks and investment processes.

3.54 In the case of investing in stocks, for example, one investor might exclude uranium stocks on environmental grounds, while another might invest in them on the basis that they help reduce carbon pollution.

3.55 There can also be different levels of acceptability for 'unethical' behaviour by investors on the basis of the investment criteria they use to select stocks or screen corporate behaviour. For example, the 'ethical high ground' an investor may claim is associated with the placement of insulation batts in ceilings to reduce carbon emissions begins to lose its appeal if the companies

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[63] Lewis, A. (2002) *Morals, Markets and Money*, Prentice Hall, London; Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT.

[64] Mr Duncan Paterson, *Transcript of evidence*, 22 March 2011, p. 26.

installing the batts are involved in questionable or risky practices.[65]

3.56 Furthermore, dilemmas arise in relation to blanket exclusions of stocks on whole of sector or industry grounds. For example, in the case of the aviation sector, air transport is a major activity in the world economy and a critical component of doing business in a globalised world. However, the aviation sector is considered to be a key contributor of $CO_2$ emissions and a response by some investors has been to insist on a blanket exclusion of the sector on the grounds that it is unsustainable. However, excluding companies on the basis of sector or industry means that investors lose the opportunity to promote change. Furthermore, blanket exclusions disadvantage companies within an industry who are striving to change practices or divest unethical stock. In the aviation industry, for example, British Airways is regarded by some as one of the world's top 100 sustainable companies.[66] Investors therefore need to consider the importance of promoting change through engagement and integration investment strategies.

3.57 Another dilemma relates to corporations that have diversified interests, such as Woolworths and Wesfarmers. Woolworths, for example, now controls over 14 000 poker machines: is it a gambling company or a supermarket? Furthermore, it also now controls over 60 Dan Murphy Liquor stores: is it an alcohol retailer or a supermarket?[67]

3.58 The Committee heard evidence that research is currently available answering the potential dilemmas that may arise with regard to corporations that have diversified interests as illustrated in the example above.

**Where do investment decisions stop, i.e., where does an investor draw the line?**

3.59 Investing is also a process that leads to the production of a good or service, so where do investment decisions stop or where does an investor draw the ethical line, for example, between the production of steel and the

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65 Hughes, D. (2011) Dilemmas of being ethical, *Australian Financial Review*, 27 April.

66 Bachoo, K., Burrit, R.L., Tan, C.W. (2005) Sustainability ratings: A Social Responsibility Investment Perspective on Listed Airline Companies in Australia, School of Accounting and Business Information Systems, Australian National University; Innovest. (2005), available online: www.innovestgroup.com

67 Kirby, J. (2006) The Myth of Ethical Investment, *The Monthly*, 5 July; Woolworths Limited. (2011) *2010–11 Annual Report*.

manufacturing of armaments?.[68]

3.60 Furthermore, ethically related investment decisions are:

> ...increasingly recognising that it is not just about the assets that you buy or the types of business practices, it is also about the investment practices that you participate in.[69]

3.61 Others suggest that investment decisions should not consider the accidental or unintended outcomes or consequences of an investment process or practice.[70]

3.62 The former Treasurer, in evidence to the Select Committee on Estimates 2010–11, highlighted some of the issues that arise with regard to where investment decisions stop:

> ...there are different and competing priorities which I am not sure I am reconciled to yet. If you do seek to move to screen or not allow certain investments or holdings in certain companies, how do you do that and to what extent do you move down that route?
>
> The examples Treasury have *[sic]* given me in some of the discussions we have had include: do you exclude tobacco companies? But then it gets down to: do you exclude investment in companies that might grow tobacco on the farm? How far do you go down that chain to exclude if you take this view? I think it is very complicated and I certainly do not have all the answers. I think it is a piece of ongoing work.[71]

## Are doing well by doing good investments good performers?

3.63 Whilst the principles behind ethical investment (EI) and socially responsible investment (SRI) have merit, and many investors are supportive of this type of investment, a common criticism or general perception is that as a form of investment it may reduce portfolio performance. An examination of the literature advances two key overarching arguments for this perception:

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68 Hughes, D. (2011) Dilemmas of being ethical, *Australian Financial Review*, 27 April.

69 Mr Scott Donald, *Transcript of evidence*, 2 August 2011, pp. 84–85.

70 Lewis, A. (2002) *Morals, Markets and Money*, Prentice Hall, London.

71 Ms Katy Gallagher MLA, Select Committee on Estimates 2010–11, *Transcript of evidence*, 17 May 2011, p. 261.

> *[in the first]*… instance financial theory argues that ethical investing will under-perform over the long term because ethical portfolios are subsets of the market portfolio, which lack sufficient diversification. Another frequently posed argument is that selecting stocks according to ethical screens can be an expensive practice that may ultimately have a negative impact on net return. Therefore the general perception has been that ethical portfolios are likely to under-perform their conventional peers.[72]

3.64 In practice, for example, in the case of screening strategies, it is suggested that the application of non-financial screens can restrict investment opportunities, reduce diversification efficiencies, and therefore unfavourably impact on performance.[73] However, the Committee was told:

> In general, there is very extensive literature on the impact of screening on returns and the general conclusion is that there is no risk of adverse impact, providing the screening is not excessive. If you screen so that you only own 10 out of 200 companies, say, listed in the ASX 200—listed on the Australian Stock Exchange—you are going to have a problem. If you do not screen so onerously, there is no adverse impact and quite often there is a positive impact.[74]

3.65 As to whether there was a performance gap between non-ethical and ethical portfolios, the Committee was told:

> …in a context where there are private sector trustees with a common law duty to act in the best interests of the members of the super fund, say, the overwhelming conclusion from all of that material is that, as long as the screens are not too onerous that you are losing a decent fraction of the companies, there is no adverse impact on returns and often you can point to periods, times and situations where there is a positive impact.[75]

3.66 A number of empirical studies in the literature specifically analysing the financial performance of ethical funds against more conventional market benchmarks, albeit across different parameters, jurisdictions and investment universes, can be cited to generally support the proposition that there is 'no detectable lessening in performance of screen investment portfolios'[76] or no

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72 Bauer, R., Otten, R. and Tourani-Rad, A. (2003) *Ethical Investing in Australia; Is there a financial penalty?*, Maastricht University, p. 3.

73 Lee, D.D., Humphrey, J., Benson, K.L. and Ahn, J. (2010) Socially Responsible Investment Fund Performance: The Impact of Screening Intensity, *Accounting and Finance*, **50**, 2, pp. 351–370.

74 Mr Howard Pender, *Transcript of evidence*, 22 March 2011, p. 4.

75 *Ibid.*, p. 13.

76 Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT, p. 75.

significant differences in the long-run returns between ethical and non-ethical funds.[77]

3.67 For example, Bauer, Koedijk and Otten (2002) measured the risk adjusted performance of 103 German, US and UK ethical mutual funds for the period 1990–2001, and found no significant differences between their returns compared with unscreened funds.[78] Statman (2000) and Gregory, Matatko and Luther (1997) respectively found no significant difference between the performance of ethical and non-ethical unit trusts in the UK and US.[79]

3.68 According to performance data for ethical, sustainable or socially responsible Australian equity managed funds to 31 March 2011, returns from ethical and mainstream funds:

> …have been broadly similar over three to five years. During the three years to March 2011, the average return from ethical funds was about 0.7 per cent, compared with about 0.6 per cent from mainstream offerings. Over five years, the returns were 2.5 per cent and 2.3 per cent respectively.[80] [The Committee is unable to determine whether these percentages are expressed 'net of fees'.]

3.69 However, notwithstanding the above, others have cautioned that studies concerned with the performance of ethical investments need to be considered in the context of a lack of consistency in a definition for an ethical investment or an ethical portfolio. Furthermore, considerable care is required as different criteria can be used to exclude stocks or screen corporate behaviour together with different strategies to give effect to specified criteria. For example, it could be argued that comparisons between ethical funds that

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[77] Lee, D.D., Humphrey, J., Benson, K.L. and Ahn, J. (2010) Socially Responsible Investment Fund Performance: The Impact of Screening Intensity, *Accounting and Finance*, **50**, 2, pp. 351–370; Bauer, R., Otten, R. and Tourani-Rad, A. (2003) *Ethical Investing in Australia; Is there a financial penalty?*, Maastricht University, pp. 1–33; Chow, G.W.S., Durand, R.B. and Koh, S. (2008) Are Ethical Investments Good?, Business School of the University of Western Australia; Cummings, L.S. (2000) The Financial Performance of Ethical Investment Trusts: An Australian Perspective, *Journal of Business Ethics*, 25, pp. 79–92.

[78] Bauer, R., Koedijk, K. and Otten., R. (2002) International Evidence on Ethical Mutual Fund Performance and Investment Style, Working paper 02.59, Limburg Institute of Financial Economics (LIFE).

[79] Statman, M. (2000) Socially Responsible Mutual Funds, *Financial Analysts Journal*, May–June, pp. 30–39; Gregory, A., Matatko, J. and Luther, R. (1997) Ethical Unit Trust Financial Performance: Small Company Effects and Fund Size Effects, *Journal of Business Finance and Accounting*, 24, 5, pp. 705–724.

[80] Hughes, D. (2011) Dilemmas of being ethical, *Australian Financial Review*, 27 April; Morningstar. (2011) Performance data for ethical, sustainable or socially responsible Australian equity managed funds to 31 March 2011.

exclude tobacco, alcohol and gambling with ethical funds that apply positive screens are not suitable. In summary:

> The lack of definition of ethical and socially responsible investing would, one would expect, only allow comparison between funds that applied certain screening criteria against general market performance—and conclusions could only be drawn regarding the efficacy or otherwise, of that specific ethical and socially responsible investing strategy. Extrapolation of these results across all ethical and socially responsible investing investments or portfolios, would have to be treated with some caution. General pronunciation that ethical stocks or ethical portfolios outperform or underperform more traditional approaches must be seen in this light.[81]

3.70 Whilst the literature suggests that there is no risk to returns if screening is not onerous or severe, the Committee was interested to know whether the specified investment criteria and screening strategy, as detailed in the proposed Bill, would affect returns for the Territory. The Executive Director of Australian Ethical Investment Limited was of the view:

> The immediate question is: is it going to affect the returns? That is the first question people will ask. I think if the screening bill that I have seen was passed it would be pretty unlikely that it would affect international returns. Screening is not severe enough.
>
> *[However,]* with the exception of one criterion, I do not think it would affect Australian returns. There is one criterion, which is the "mining processing or sale of coal or extraction of oil". That would exclude a significant number of companies. In that case, you get back to the British East India Co-global warming situation: are you actually going to improve your returns by screening out those companies or is there a risk they might be worse? I think there is a risk on that particular criterion that there might be times when they are worse.[82]

3.71 Another matter raised in the context of performance relates to additional costs that may be incurred from implementing an ethical investment strategy. Specifically, this is concerned with the fees investors pay for ethical funds as compared with mainstream funds. According to Morningstar, the average ongoing fee for ethical funds is approximately 1.7 per cent,

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[81] Cronin, J.D. (2004) *From Ethical Investment to Investment Ethics—Towards a normative theory of investment ethics,* A thesis submitted to fulfil the requirements for the award of a Doctorate of Philosophy, QUT, p. 76.

[82] Mr Howard Pender, *Transcript of evidence*, 22 March 2011, p. 4.

compared with 1.5 per cent for mainstream funds.[83] The Executive Director of the Responsible Investment Association Australasia told the Committee:

> The funds that are offered—and when one looks at their management fee or the fee that is applied that might be different from a regular fund, it is important to look at how these fees might vary from what we call passive investing. One must compare apples with apples. So across the board any type of selective investment, what we call active investment, will incur probably a slightly larger fee. That fee could range from, say, 25 basis points extra through to maybe 100 basis points extra. So that is one-quarter of a per cent *[to one per cent].*
>
> …
>
> Through to maybe over one per cent more than a regular fee. Those fees vary, but I think it is very important to point out that most active funds charge a larger fee. So because ethical investment screening requires active investment, thereby it would fall into the same category as the government investing in any other actively managed fund. And to answer your question, yes, it does cost more money and it does take more resources to do that. Again, one would want to match this up against the objectives and the outcomes that you are seeking.[84]

3.72 Increased fund fees therefore have the potential to detract from the performance of 'doing well by doing good' investments by reducing returns.[85]

3.73 A Treasury Directorate analysis of the impact of the proposed Bill, obtained under freedom of information laws, estimated the cost of setting up a negative and positive screening investment system, in the first instance at $2.8 million to $8.5 million added to $5.7 million to $9.9 million per annum in management fees.[86]

3.74 The Government submitted that general pronouncements that ethical stocks or ethical portfolios will outperform or underperform more traditional investment approaches must be viewed with caution. Furthermore, the Government also noted that ethical investment products are, in most cases,

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[83] Hughes, D. (2011) Dilemmas of being ethical, *Australian Financial Review*, 27 April; Morningstar. (2011) Performance data for ethical, sustainable or socially responsible Australian equity managed funds to 31 March 2011.

[84] Ms Louise O'Halloran, *Transcript of evidence*, 7 July 2011, p. 70.

[85] Geczy, C., Stambaugh, R. and Levin, D. (2005) Investing in Socially Responsible Mutual Funds, Working Paper, University of Pennsylvania; Hughes, D. (2011) Dilemmas of being ethical, *Australian Financial Review*, 27 April.

[86] Mannheim, M. (2010) Review of Govt investment opens, *Canberra Times*, 16 November, p. 3.

more expensive than traditional investment products.[87]

3.75 It goes without saying that the 2008 Global Financial Crisis (GFC) well and truly placed the role of investors in society on the global agenda. Fundamentally, it raised questions about their role in terms of the specific investments they make and the extent to which their investment decisions and practices take account of non-financial considerations.[88]

3.76 It is without debate that investing with a conscience, either in its earlier forms throughout history to its contemporary practice, has played, and continues to play, a leading and progressive role in emphasising and/or responding to a range of wider social and environmental considerations. This includes, for example, contributions to the climate change debate, labour standards, access to medicines, and addressing bribery and corruption.[89] A key issue for consideration though, as part of this inquiry, is the role governments, as institutional investors, have or should have in this form of investment.

[87] Submission No. 5, March 2011, p. 26.

[88] Vines Fiestas, H., Sullivan, R. and Crossely, R. (2011). *Better returns in a better world—responsible investment: overcoming the barriers and seeing the returns*, Oxfam—Great Britain.

[89] *Ibid.*

# 4 THE ACT GOVERNMENT AS AN INVESTOR

## The role of government as an investor

4.1 The role of government in the practice of 'doing well by doing good' investment can take a number of forms ranging from informational to leading by example. Research conducted by the European Commission examining government initiatives and the industry's expectations with regard to the role of government in this form of investment practice identified six groupings of initiatives. These are summarised in the table below.

**Table 3.1— Summary of government initiatives in the practice of doing well by doing good investment**[90]

| Initiative grouping | Description |
|---|---|
| **Informational** | Informational instruments include:<br>o websites and other informational activities (leaflets, brochures )<br>o campaigns<br>o guides or guidelines<br>o criteria catalogues<br>o training and other educational activities<br>o research—collaboration with universities/Think Tanks to stimulate interest |
| **Partnering** | Partnering instruments include:<br>o networks (with government involvement/funding)<br>o voluntary agreements between government bodies and businesses<br>o public-private partnerships<br>o research—collaboration with universities/Think Tanks to stimulate interest |
| **Economic /financial** | Economic/financial instruments include<br>o tax incentives<br>o bonus payments<br>o subsidies<br>o awards/process for investment ethics offerings/opportunities |
| **Legal** | Legal instruments include:<br>o disclosure requirements directly linked to investment ethics (for example, for Sovereign Wealth Funds—pension funds) |
| **Hybrid** | Hybrid instruments such as:<br>o government strategies/action plans to facilitate investment ethics<br>o centres/platforms on investment ethics that make use of a combination of other instruments listed in the above initiative groupings |
| **Lead by example** | Lead by example initiatives include:<br>o government investing their own resources in line with investment ethics' criteria |

90 Steurer, R., Margula, S. and Martinuzzi, A. (2008) *Socially Responsible Investment in EU Member States: Overview of government initiatives and SRI experts' expectations towards governments—Final Report to the EU High-Level Group on CSR*, European Commission, Research Institute for Managing Sustainability, Vienna University, April, pp. 1–56; George, A., Edgerton, N. and Berry, T. (2005) *Mainstreaming Socially Responsible Investment (SRI): A role for government?*, Institute of Sustainable Futures—University of Technology, Sydney, November, pp. 1–47.

4.2 The initiative pertinent to this inquiry is that of 'leading by an example', as an institutional investor. Many governments give effect to this by way of their respective public pension funds. Public pension funds are by far the most targeted group of governmental 'doing well by doing good' investment initiatives because:

> …they are by definition long-term investors, and because they have large amounts of money at their disposal. Furthermore…governments *[can]* use public pension schemes as flagships to demonstrate their commitment to EI and SRI.[91]

4.3 It is also noted that, in the globalised world, the extent to which the State, as an entity, can exert influence across a range of business parameters, including 'doing well by doing good' investment, has diminished proportionally to the growing influence of the corporation. For example, as at 2000, a list of the top 100 largest economies—constructed by the comparison of country gross domestic products (GDP) and corporate sales—included 51 corporations and 49 countries.[92] That study found that: General Motors is now bigger then Denmark; DaimlerChrysler is bigger than Poland; Royal Dutch/Shell is bigger than Venezuela; IBM is bigger than Singapore; and Sony is bigger than Pakistan.[93] That same study also found that the 1999 sales of 'each of the top five corporations (General Motors, Wal-Mart, Exon Mobil, Ford Motor and DaimlerChrysler) *[were]* bigger than the GDPs of 182 countries'. The Committee notes that some of these relativities have changed since the GFC. Notwithstanding this, the principle as highlighted in the example cited, remains, that is, the extent to which the State, as an entity, can exert influence across a range of business parameters has been impacted by the growing influence of the corporation in the contemporary globalised world.

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[91] Steurer, R., Margula, S. and Martinuzzi, A. (2008) *Socially Responsible Investment in EU Member States: Overview of government initiatives and SRI experts' expectations towards governments—Final Report to the EU High-Level Group on CSR*, European Commission, Research Institute for Managing Sustainability, Vienna University, April, pp. 1–56.

[92] Anderson, S. and Cavanagh, J. (2000) Top 200: The Rise of Corporate Global Power, Washington Institute for Policy Studies; Ghahramani, S. (2011) Governments, Financial Markets, And International Human Rights: The State's Role as a Shareholder, *Yale Journal of International Affairs*, Winter, pp. 85–95.

[93] *Ibid.*

## Government investment criteria

4.4 As noted previously, in the case of governments, as institutional investors, norms-based investment criteria are considered more appropriate. Some examples used by public pension funds are set out in the tables following.

**California Public Employees' Retirement System (CalPERS)—**The California Public Employees' Retirement System (CalPERS) engages in both financial and social activism and uses SRI as an investment strategy. Its shareholder activism is not a standard practice adopted by public pension funds. While some funds do engage in substantial levels of shareholder activism, a significant number do not.

With investments exceeding $200 billion as of December 2010, it is the largest public pension fund in the US. To achieve its objectives, CalPERS has adopted a set of Global Principles that establishes the framework by which the fund executes its shareowner and proxy voting responsibilities. For example, human rights considerations are one of those principles. CalPERS recommends, for instance, that 'corporations adopt maximum progressive practices toward the elimination of human rights violations in all countries or environments in which the company operates' and adhere to the Global Sullivan Principles as well as the United Nations Global Compact.

The United Nations Global Compact is based on several international treaties and emphasises the importance of human rights and labour conditions in business considerations. CalPERS requires its managers to give effect to its investment principles through the rigorous evaluation of potential investments in accordance with these principles.[94]

**Norwegian Government Pension Fund Global (GPFG)—**Norway's GPFG, which manages $325 billion, is considered to be one of the world's largest sovereign wealth funds (SWF). The GPFG has become the best practice benchmark for EI and SRI by SWF. As compared with CalPERS, the GPFG, in the main, does not exclude specific countries from its investment universe. The GPFG strongly considers ethics and human rights in its investment objectives and is perceived as an activist shareholder.

The GPFG investment approach is mostly directed at individual corporations. Under the law, Norway's Ministry of Finance requires the GPFG to not invest in, or divest from, companies that: (i) 'produce weapons that violate fundamental humanitarian principles through their normal use'; (ii) 'produce tobacco'; and (iii) 'sell weapons or military material' to specific countries highlighted in the GPFG's guidelines.

The Finance Ministry's decisions regarding which companies must be excluded from the fund's investment universe are based on a robust and dynamic process that, in the main, relies on non-binding advice from a body called the Council on Ethics. In considering this advice, the Ministry may exclude companies that have been responsible for, or may contribute to: (i) human rights violations such as murder, torture, deprivation of liberty, child exploitation, and labour abuses; (ii) violations of individual rights during war or other conflict; (iii) environmental damage; (iv) corruption; and (v) other severe breaches of ethical principles.

In the early stages of its review process, the Council on Ethics is required to give due process opportunities to companies that are being considered for exclusion from the fund's portfolio and must describe the grounds for its recommendations. To determine whether a company must be excluded, the Ministry goes through a lengthy process that includes consideration of the following factors: (i) the probability of future violations; (ii) the violations' severity; (iii) whether the company is taking reasonable steps to reduce the risk of future violations; (iv) whether the company is working to protect good corporate governance as well as environment and social conditions; and (v) whether the company is making positive contributions to those affected by the company's misconduct. The Council must regularly assess if the bases for its exclusion have changed. If they have, the Council may advise the Ministry to overturn a prior ruling on exclusion.[95]

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[94] CalPERS, Investment Facts, available at: http://www.calpers.ca.gov/eip-docs/about/facts/investme.pdf; Barber, B.M. (2007) Monitoring the Monitor: Evaluating CalPERS' Activism, *Journal of Investing*, 16, 4, pp. 66-80; Hess, D. (2007) Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development, *Virginia Law & Business Review*, 2, 2, pp. 221-263; CalPERS, "Global Principles," Principle 5.1, http://www.calpers-governance.org/docs-sof/principles/2010-5-2-global-principles-of-accountable-corp-gov.pdf.]

[95] Nugee, J, Rozanov, A. and Hoguet, G. (2009) *Sovereign wealth funds: Emerging from the financial crisis*, Boston, MA: State Street Corporation, pp. 85–104; The Norwegian Government Pension Fund:

**French Pension Reserve Fund (Fonds de réserve pour les retraites – FRR)**

The French Pension Reserve fund (Fonds de réserve pour les retraites - FRR) was established in July 2001 after separating from the French Old Age Solidarity Fund (Fonds de Solidarité Vieillesse – SV), which had been established in 1999.

Since its establishment, the FRR as an independent, publicly owned administrative agency, is funded and controlled by the French ministries responsible for social security, the economy and budget. The FRR views its role to be one of investing its financial resources on behalf of the public and to use its assets to support finance the general old age insurance plan and affiliated plans as of 2020.
The FRR applies an SRI investment strategy. In its latest SRI investment strategy from June 2005, the FRR had the following main objectives:

- 'to maximize investment returns over the long term and under the best possible conditions of security', and
- to pursue 'certain shared values that promote economically, socially and environmentally sustainable development'.

The FRR assess companies for investment carefully with regard to their social and environmental performance by following the UN PRI. Supplementing this, the FRR has developed its own set of SRI principles to guide investment decisions and to strengthen its commitment towards SRI. These SRI principles are:

+ respect for international law and basic worker rights
+ corporate environmental responsibility
+ respect for consumers and fair trade practices in local markets, and
+ promotion of best corporate governance principles and practice.

Furthermore, the FRR actively encourages transparency with regard its fund resources via public disclosure of its strategy and financial statements at regular intervals.[96]

4.5 One member postulated that the choice of what norms to consider is an ethical decision—what areas do you think are important enough to warrant application of the norm and possible exclusion? As noted above, the Norwegian Government Pension Fund Global uses ethical considerations to exclude stocks, i.e., negative screening.

4.6 Some suggest that the role of government-sponsored entities as market participants is a complex one to judge, in particular in the context of determining their stated ethical objectives and how these are put into practice. Though, as noted in the examples contained in this chapter, the entities profiled all used norms-based investment criteria accompanied by entity specific principles.

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Provisions on the Management of the Government Pension Fund—available at: http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/the-guidelines-for-the-management-of-the.html?id=434605; Norway Ministry of Finance, Guidelines for Observation and Exclusion from the Government Pension Fund Global's Investment Universe—available at: http://www.regjeringen.no/en/sub/Styrer-rad-utvalg/ethics_council/Ethical-Guidelines.html?id=425277.

96 Steurer, R., Margula, S. and Martinuzzi, A. (2008) *Socially Responsible Investment in EU Member States: Overview of government initiatives and SRI experts' expectations towards governments—Final Report to the EU High-Level Group on CSR*, European Commission, Research Institute for Managing Sustainability, Vienna University, April, p. 31; French Pension Reserve fund—http://www.fondsdereserve.fr.

4.7 The dilemma for governments, as institutional investors, in the practice of 'doing well by doing good' investment is that they are:

> ….the guardians of the financial interests of their beneficiaries. In the case of public pension funds such as CalPERS, the beneficiaries include the California state employees who depend on the fund for their retirement. In the case of GPFG, the beneficiaries are future generations of Norwegians who hope the fund exercises due diligence in protecting their financial interests and the country's wealth. A question thus arises as to whether it is ethical for these entities to engage in social investing that may, at times, be deemed by some to be politically or non-financially inspired and may not deliver the best financial results. Some scholars have argued that certain types of political interference in public fund operations, including divestment requirements, may prove costly to public pensions and may cause them to earn significantly lower returns than their private counterparts.[97]

4.8 Some examples cited in the literature concerning political interference in the operation of public funds, for example, by divestment requirements, and their impacts on returns are set out below.

4.9 In the case of the CalPERS, it has been estimated that the California legislature's 'apartheid-era requirement' that the fund divest from companies that did business in South Africa may have cost the fund's beneficiaries about $500 million.[98]

4.10 Furthermore, it has been argued that whilst CalPERS' financial activism aimed at improving corporate governance practices has brought significant financial returns to its portfolio, its socially-based decision to divest all of its holdings from tobacco companies may have caused the fund to suffer a $650 million loss between 2000 and 2006.[99]

4.11 Norms-based investment criteria or principled based investment criteria are essential for any form of EI or SRI investment by governments. The basis for

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[97] Ghahramani, S. (2011) Governments, Financial Markets, And International Human Rights: The State's Role as a Shareholder, *Yale Journal of International Affairs*, Winter, p. 92.

[98] Coronado, J.L., Engen, E.M, and Knight, B. (2003) Public Funds and Private Capital Markets: The Investment Practices and Performance of State and Local Pension Funds, *National Tax Journal*, **56**, 3, pp. 579–594; Ghahramani, S. (2011) Governments, Financial Markets, And International Human Rights: The State's Role as a Shareholder, *Yale Journal of International Affairs*, Winter.

[99] Barber, B. (2005), Monitoring the Monitor: Evaluating CalPERS' Activism, *Social Sciences Research Network*, November, pp. 66–80; Ghahramani, S. (2011) Governments, Financial Markets, And International Human Rights: The State's Role as a Shareholder, *Yale Journal of International Affairs*, Winter.

this is two-fold: (i) firstly, it acts as a safeguard against EI and SRI practices becoming captured politically, for example, by not permitting a group of people to become sole arbiters of what should or should not be invested in. Norms-based criteria, as illustrated in the public pension funds profiled in this chapter, rest on universally agreed and accepted principles, in the form of international standards, treaties and conventions; and (ii) are a means by which governments, as investors, can effectively represent the will of their public beneficiaries, in the form of superannuation investments, and more generally, via investment of financial resources on behalf of the public and to use these returns to fund public programs and long term policies and plans.

4.12 To illustrate the important role norms-based investment criteria play in preventing EI and SRI practices from becoming captured politically, two examples follow.

4.13 First—in the case of Norway's GPFG, after Norway's Ministry of Finance excluded three Israeli companies from its portfolio, Norway's labour union umbrella group, the LO, called on the GPFG to exclude Israel from its portfolio altogether after the country's raid on ships carrying aid to Gaza. In response, the Ministry of Finance did not comply and emphasised publicly that it 'based its decisions on ethics and not politics'.[100] In a public statement issued by the Ministry, it noted:

> It is not in keeping with the ethical guidelines to exclude all companies located in a particular geographic area or country…If we exclude companies due to their presence in a region, or because of a particular nationality, the fund would be perceived as a foreign policy instrument.[101]

4.14 Second—in the case of Australia's Future Fund, during questioning by a Senate committee earlier this year, as to whether the Fund would divest its $150 million stake in 14 tobacco companies if the Commonwealth government was successful in implementing its plain packaging requirements, the Fund's Acting Chief Investment Officer stated:

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[100] Ghahramani, S. (2011) Governments, Financial Markets, And International Human Rights: The State's Role as a Shareholder, *Yale Journal of International Affairs*, Winter, p. 92.

[101] Norway Government (2010). Norway Sovereign Fund Won't Exclude Israeli Companies," *Pensions & Investments*, **38**, 12, p. 26.

> No, because we do not believe that the manufacturers are doing anything that is illegal in Australia so there is no consideration as to whether we should exclude tobacco. What we do, and more importantly what we require our investment managers to do—the vast bulk of all of our investments are essentially run through external investment managers—is to take into account and integrate a broad suite of issues when they are evaluating the different investments that they can invest in. That would include the influence on any one share price of that type of policy decision, and indeed every other policy decision that is made by the government here and anywhere else in the world. I guess there is an impact, but it would be very small. The impact on those manufacturers of one nation having one policy will be taken into account by the people who select those stocks for us and the relative price that they pay for those stocks.
> ...
> The board's policy is pretty clear. The board will consider the financial benefits of investing in any company, providing its activities in relation to its Australian operations are legal according to Australian law. The international version of that is the international conventions that Australia supports. So, if there were a company that was in breach of either of those two then we would exclude them from our portfolio.[102]

## Legislative precedent

4.15 The Government submitted that it had been unable to locate any precedent either in Australia or elsewhere where investment limitations and obligations to the extent specified in the proposed Bill had been prescribed in legislation. The Government noted that legislation introduced into the New Zealand (NZ) Parliament in 2010[103] to provide an 'ethical investment framework' for its Crown financial institutions had been defeated.[104]

4.16 The Committee also has been unable to find a legislative precedent that correlates with the investment criteria and strategy, that is, the investment limitations and obligations, as prescribed in the proposed Bill. The closest example, also noted by the Government, is the NZ Parliament's Ethical Investment (Crown Financial Institutions) Bill 2010. Consideration of the NZ

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[102] Mr David Neal, *Transcript of evidence*, 26 May 2011, Australian Senate Finance and Public Administration Legislation Committee, Estimates 2011, pp. 28–29; Anderson, F. (2011) Future Fund finds no fault in plain tobacco, *Australian Financial Review*, 27 May, p. 7.

[103] NZ Parliament—House of Representatives. (2010) Hansard Parliamentary debates, 4 August, volume 665, p. 13003.

[104] Submission No. 5, March 2011, p. 23.

Bill is pertinent to this inquiry, in particular in relation to its investment criteria and strategy together with the reasons for why the Bill was defeated. These are discussed below.

4.17 The NZ Parliament considered the Ethical Investment (Crown Financial Institutions) Bill in 2010. That Bill proposed amendments to legislation applicable to each of NZ's five Crown financial institutions, to specify:

> …investment policy criteria consistent with internationally recognised norms and conventions for ethical and socially responsible investment.[105]

4.18 Importantly, as compared with the proposed Bill under consideration by the Committee, the NZ Bill: (i) provided a definition for ethical in the context of the Bill—notwithstanding that ensuing debate by Members raised issues concerning definitions, in particular with regard to EI and SRI and its associated practice; (ii) specified norms-based or principled based investment criteria; and (iii) acknowledged that the main investment objective of its Crown financial institutions:

> ...is and should be to generate healthy returns that can fund our future commitments to accident compensation, superannuation, and other key initiatives. This bill will not change that, nor does it aim to change that…This bill continues that as a key goal, but it introduces meaningful criteria to guide and instruct those funds to invest in a manner that is ethical and socially responsible.

4.19 The Bill was defeated, in the main, on the following grounds:

- the subjective nature of the terms associated with EI and SRI together with an inability to precisely define these key terms
- the proposed investment objectives detailed in the Bill were already being achieved through operational policies and guidelines developed by each of the Crown financial institutions not by legislated policies and governance structures. For example, in addition to specific policies on EI, SRI or RI, the five institutions were representative of signatories to the UN PRI, the UN Global Compact, the Carbon Disclosure Project and members of the Investor Group on Climate Change (IGCC), and
- that in considering the nature of investment, ethical investment was already taking place and will continue through the marketplace.[106]

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105 NZ Parliament—House of Representatives. (2010) Hansard Parliamentary debates, 4 August, volume 665, p. 13003.

106 NZ Parliament—House of Representatives. (2010) Hansard Parliamentary debates, 4 August, volume 665, p. 13003; Submission No. 5, March, p. 23.

4.20 In summary, what the NZ Bill was aiming to accomplish was already being achieved through current processes—by established and developed ethical investment policies within each of the Crown financial institutions and the market process. On these grounds, the Bill was considered by many to be unnecessary as it replicated what was already taking place.

## Current ACT Government investment policy

4.21 The Committee was told that the Government has developed and implemented a 'doing well by doing good' investment policy. The Government described its approach to this practice of investment as that of responsible investment which is being implemented through:

> …ESG integration and active ownership policies, which is the largest sector of the responsible investment market. This sector is expected to grow significantly over time through adoption of these activities by the mainstream investment community as more investment managers and asset owners become signatories to the PRI. As the responsible investment market continues to mature, the Government is watching developments closely; the ability to apply a range of responsible investment strategies to the Territory's investment practices into the future is possible and encouraging, without compromising investment returns.[107]

4.22 In its submission, the Government explained it had:

> ...established an investment framework that incorporates the key objectives of the United Nations Principles for Responsible Investment (PRI)...[108]

4.23 In evidence, a Treasury Directorate official elaborated further:

> The government's policy in relation to investments to date has been that we will be a signatory to the principles for responsible investment, and we will conduct ourselves accordingly. Part of that is that we want the voting policies to reflect the fact that for investment purposes we have a balance between the fiduciary duty and the long-term benefits to the companies that are involved in the investments, and that means taking into account not just financial returns but the impact for the companies of ESG criteria.
>
> So that is our policy and that is the way we are implementing it. I think most of the managers we have got on board were put in place prior to us signing up to the PRI, but we have, since signing up, gone back to them and checked on their

[107] Submission No. 5, March 2011, p. 5.

[108] *Ibid.*, pp. 4–5.

> credentials in that regard. Certainly, at any point in the future when we change managers, it will be on the basis that that manager has adopted the principles for responsible investment.[109]

4.24 The Committee was interested to know whether there may be any legislative impediments to implementing an investment framework to support the objectives as detailed in the proposed Bill. The Executive Director of Australian Ethical Investment commented:

> I just want to talk about the situation in the ACT. The self-government act says that the public money of the territory can be invested as provided by enactment. There is not much high level legal constraint on that enactment, except for the obligation to make laws for the peace, order and good government of the territory.
>
> The ACT Treasury choose to be a responsible investor at the moment. As far as I can see, that is a choice that they are making with the support of the executive but without any explicit enactment as to the situation.
>
> The ACT parliament could choose to be a socially responsible/ethical investor if it wanted. It could do that so that its investment activities were consistent with the intent of other ACT laws. It is important to understand that the ACT parliament does not have private sector trustee-like obligations, which the ACT Treasury might choose to assume in the absence of some enactment.[110]

4.25 In evidence, an official from the Treasury Directorate explained how the UN PRI are applied as part of the Territory's current investment policy:

> I think this gets back to people's interpretation of what they see the principles being and what the principles stand for, as opposed to adopting an ethical or values-based framework. Our view, and the way we apply the principles for responsible investment, is that it is about ensuring that the assessment of every investment is incorporating a whole range of factors. That might be future earnings of a company, what sort of issues the company is involved in and those sorts of things, and you break down that assessment to all the parts to come up with an appropriate evaluation.
>
> We are trying to get our investment managers to look at the universe of stocks and make an evaluation as to where they think that investment stacks up relative

[109] Mr Roger Broughton, *Transcript of evidence*, 7 July 2011, p. 62.

[110] Mr Howard Pender, *Transcript of evidence*, 22 March 2011, p. 3.

> to other investments. So if it is a legal product, if it is a legal business, that is the assessment that is made.[111]

4.26 In summary, the Government told the Committee that it has given effect to the practice of 'doing well by doing good' investment through a responsible investment framework that incorporates the United Nations Principles of Responsible investment.

4.27 Notwithstanding the Government's articulated policy on responsible investment, in particular as a signatory to the United Nations Principles of Responsible Investment, the Committee notes that there appears to have been no change in investment activity or voting positions as a result of this policy.[112]

## United Nations principles for responsible investment

4.28 The notion that investors should also maximise shareholder welfare (or have social and environmental responsibilities) is increasingly accepted in the investment industry.[113] The number of current signatories to the United Nations (UN) Principles for Responsible Investment (PRI) is testament to this. As at the end of October 2010:

> …827 investors, with the responsibility for more than $25 trillion of assets, and representing 15 per cent of total global markets, had become signatories to the PRI.[114]

4.29 The Principles were developed by a consortium of 20 of the world's largest institutional investors representative of 12 countries; and other experts on EI drawn from intergovernmental and governmental organisations, civil society[115] and academia. The process was coordinated by the UN

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[111] Mr Patrick McAuliffe, Standing Committee on Public Accounts, Inquiry into 2009–10 Annual Reports, *Transcript of evidence*, 4 November 2010, p. 17.

[112] Mannheim, M. (2010) Greens to seek ban on 'unethical investment', *Canberra Times*, 21 September, p. 2; *Transcript of evidence*, 7 July 2011; Standing Committee on Public Accounts, Inquiry into 2010–11 Annual Reports, Proof *transcript of evidence*, 24 November 2011.

[113] Etzioni, A. (1988) *The Moral Dimensions: Toward a New Economics*, The Free Press, New York; Vines Fiestas, H., Sullivan, R. and Crossely, R. (2011). *Better returns in a better world—responsible investment: overcoming the barriers and seeing the returns*, Oxfam—Great Britain.

[114] Vines Fiestas, H., Sullivan, R. and Crossely, R. (2011). *Better returns in a better world—responsible investment: overcoming the barriers and seeing the returns*, Oxfam—Great Britain, p. 17; www.unpri.org.

[115] The World Bank has adopted a definition of civil society developed by a number of leading research centers: "the term civil society to refer to the wide array of non-governmental and not-for-profit

Environment Programme Finance Initiative (UNEP FI) and the UN Global Compact Initiative. Signatories to the PRI pledge to adopt the following principles:

> As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes, and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, consistent with our fiduciary responsibilities, we commit to the following:
>
> - We will incorporate ESG issues into investment analysis and decision-making processes.
> - We will be active owners and incorporate ESG issues into our ownership policies and practices.
> - We will seek appropriate disclosure on ESG entities in which we invest.
> - We will promote acceptance and implementation of the Principles within the investment industry.
> - We will work together to enhance our effectiveness in implementing the Principles.
> - We will each report on our activities and progress towards implementing the Principles.[116]

4.30 A submission to the inquiry noted that the UN PRI is a statement of principles that is deliberately non-prescriptive in terms of the investment strategies or instruments used by signatories.[117] It is noted that some of the public commentary and discussion surrounding the proposed Bill appeared to suggest a correlation between becoming a signatory to the UN PRI and the adoption of specific investment strategies, namely exclusion-based investment, i.e., negative screening. It was further submitted to the Committee that 'doing well by doing good' investment strategies or approaches can include:

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organizations that have a presence in public life, expressing the interests and values of their members or others, based on ethical, cultural, political, scientific, religious or philanthropic considerations. Civil Society Organizations (CSOs) therefore refer to a wide of array of organizations: community groups, non-governmental organizations (NGOs), labor unions, indigenous groups, charitable organizations, faith-based organizations, professional associations, and foundations" (World Bank 2011).

116 www.unpri.org

117 Submission No. 3, February 2011, p. 1.

> ...negative screening, positive screening, best-of-sector, engagement and a range of others. It is not the case that becoming a UN PRI signatory means that an investor should begin screening companies out of their investible universe. This is certainly one of the approaches taken by signatories, but is by no means the only valid approach, with other approaches used by asset owners with an outsourced funds management model including things like engagement and voting on shareholder resolutions, for instance.[118]

4.31 The UN PRI advocate a number of actions to: (i) increase investor transparency; and (ii) incorporate ESG criteria into mainstream investment decision making. Actions to incorporate ESG criteria encourage investors to: (i) include this criterion into their investment analysis and decision making; and (ii) engage with the companies in which they invest to implement high standards of corporate responsibility and governance.[119] For example, a group of UN PRI signatories have started engaging with:

> …14 North American, European and Japanese consumer electric companies to ensure that tin, tantalum and other minerals sourced from the Democratic Republic of Congo are not linked to armed groups responsible for serious and persistent human rights' abuses.[120]

4.32 The development of the Principles signalled a shift in the 'doing well by doing good' investment community towards ESG considerations. The UN 2010 Report on PRI Progress stated that, at a conservative estimate, 7 per cent of the total global market was now subject to integration of ESG factors by signatories, up 4 per cent from 2009, representing a value of US$13.4 trillion.[121]

4.33 Whilst the UN PRI are of a voluntary nature, all investor signatories are required to complete a mandatory annual reporting and assessment survey

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118 Submission No. 3, February 2011, p. 1.

119 Steurer, R., Margula, S. and Martinuzzi, A. (2008) *Socially Responsible Investment in EU Member States: Overview of government initiatives and SRI experts' expectations towards governments—Final Report to the EU High-Level Group on CSR*, European Commission, Research Institute for Managing Sustainability, Vienna University, April, pp. 1–56; Vines Fiestas, H., Sullivan, R. and Crossely, R. (2011). *Better returns in a better world—responsible investment: overcoming the barriers and seeing the returns*, Oxfam—Great Britain, p. 17; www.unpri.org.

120 Vines Fiestas, H., Sullivan, R. and Crossely, R. (2011). *Better returns in a better world—responsible investment: overcoming the barriers and seeing the returns*, Oxfam—Great Britain, p. 18; www.unpri.org/publications—report 10.

121 UNEP Finance Initiative and UN Global Compact. (2010) 2010 Annual Report of the PRI Initiative, available at: http; Wagg, O. (2010) UNPRI signatories rise by a third; ESG integration improves, *Ethical Investor*, 13 October.

to evaluate and encourage progress against the Principles. Investors are encouraged to publicly disclose their responses. However, from 2012 onwards it will be mandatory for all investor signatories to publicly disclose their annual reporting and assessment responses.[122]

4.34 Whilst noting the public disclosure requirement from 2012 onwards, the Committee notes that the Government, as a signatory will have completed the UN PRI mandatory annual reporting and assessment survey in 2009, 2010 and 2011. The Committee believes that if these responses are not already publicly available, they should be.

### RECOMMENDATION 2

4.35 **The Committee recommends that the ACT Government table in the ACT Legislative Assembly its 2009; 2010 and 2011 United Nations Principles of Responsible Investment annual reporting and assessment survey responses.**

### RECOMMENDATION 3

4.36 **The Committee recommends that the ACT Government report annually (as an appendix to the Treasury Directorate annual report) on changes it has made to its investment portfolio as a consequence of its signatory status to the United Nations' Principles of Responsible Investment, for example, divestment of shares and changes to investment practices.**

4.37 Notwithstanding the good work that has been achieved to date by the UN PRI in terms of increased investor transparency and integration of ESG criteria into decision making there is some scepticism in the investment industry with regard to the motivations of some signatories. For example, the 2010 Lonsec review of Australian and global equity SRI funds questioned the motivations of some fund managers, 'largely at the margins of the industry' for signing up to the PRI, in that:

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[122] Vines Fiestas, H., Sullivan, R. and Crossely, R. (2011). *Better returns in a better world—responsible investment: overcoming the barriers and seeing the returns*, Oxfam—Great Britain, p. 17; www.unpri.org.

…perhaps managers are adopting a me-too, tick-the-box mentality to appease key clients as opposed to genuine belief in the investment merits of the discipline'.[123]

4.38 Since the launch of the UN PRI in 2005, it appears that a key focus has been to encourage investors to become signatories. Some have observed that the absence of minimum entry requirements or absolute performance requirements, aside from the mandatory completion of an annual reporting and assessment survey, may attract less committed signatories. Furthermore, the obligations signatories pledge commitment to are:

…qualified by noting that actions should be 'consistent with our fiduciary responsibilities' means that less-committed signatories can hide behind this clause if they decide not to take action.[124]

4.39 In 2008, the ACT Government was the first government in Australia to become a signatory to the UN PRI. The Committee was told:

...the ACT has been quite proactive in the field of responsible investment in Australia. Becoming a PRI signatory is not a small or insignificant step. There are no other government instrumentalities in Australia that have taken the same step.

The only comparative one in our region is the New Zealand superannuation scheme. That was set up under rather different circumstances as well. I thought it should be noted that amongst the governmental instrumentalities in Australia, the ACT government was actually taking quite a leading role. It would be quite nice to see the government take a stronger and more proactive line on responsible investment, because you can trade on the fact that you were the first to sign the PRI.[125]

4.40 Evidence to the Committee also emphasised that in becoming a signatory to the UN PRI, the ACT Government was:

…the first Australian government instrumentality to acknowledge the importance of ESG criteria in the investment process…By becoming a signatory, *[the ACT Government]* has not only emphasised the importance of ESG criteria, it has also indirectly influenced its service providers, the outsourced fund

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[123] Wagg, O. (2010) UNPRI signatories rise by a third; ESG integration improves, *Ethical Investor*, 13 October.

[124] Vines Fiestas, H., Sullivan, R. and Crossely, R. (2011). *Better returns in a better world—responsible investment: overcoming the barriers and seeing the returns*, Oxfam—Great Britain, p. 18.

[125] Mr Duncan Paterson, *Transcript of evidence*, 22 March 2011, p. 16.

managers, who are keenly aware of the service requirements of their clients. The significance of this power of influence should not be understated.[126]

4.41 Action undertaken by the Government since becoming a signatory to the UN PRI has included:

- the development of an ESG investment policy for the Superannuation Provision Account( SPA)
- review of equity investment manager proxy voting policies and procedures, and ongoing monitoring and reporting of all investment manager voting activities
- amendment to all current equity investment manager contracts to include provisions in relation to the Territory's current ESG requirements, as well as ongoing dialogue with Territory investment managers to continually encourage better ESG integration in investment decisions
- amendment to current Treasury investment service provider procurement processes by the inclusion of ESG requirements in all tender documentation
- appointment of an ESG research provider in relation to the Territory's equity investment portfolios
- quarterly ESG risk screening of all stock holdings and ongoing dialogue with Territory investment managers in relation to the outcomes of this analysis
- appointment of an external engagement service provider to support the Territory's company engagement process on identified ESG risks
- participation in the PRI Annual Reporting and Assessment Survey
- attendance at the PRI Annual Conference, and
- provision of ongoing reporting on the progress and activities undertaken by the Territory in relation to implementation of the PRI through established parliamentary processes and the Treasury annual report.[127]

4.42 The company Regnan—Governance Research and Engagement (Regnan—GRE)[128], was awarded a five-year contract in 2008 to advise the ACT Government on ESG risks in its investment portfolio.

4.43 The Committee understands that an independent review (now complete) of

126 Submission No. 3, February 2011, p. 1.

127 Submission No. 5, March 2011, pp. 16–17.

128 Regnan—Governance Research and Engagement was founded in 2001 by institutional investors wishing to consider ESG in the context of their fiduciary obligations (Submission No. 6, March 2011).

the Government's status as a signatory to the UN PRI formed part of the ACT Greens Parliamentary Agreement with the ACT Labor Party—clause 11.1 of that Agreement states:

> Undertake an independent review of the Government's current investment practices by the end of 2009, to determine how the UN Principles of Responsible Investment are being addressed. Subject to the outcome of the review, develop a timeline for stage implementation of the review's recommendations.

4.44 In evidence to the Select Committee on Estimates 2010–11, the former Treasurer commented:

> We have done a review on the principles of responsible investment. I am not sure what the status of that document is. I have read it and I think I want to discuss it with Treasury. Essentially, the outcome of that review was that we are operating in line with the PRI that we set out and that the processes are good. I think it was a very positive report...[129]

4.45 The Review was undertaken by an independent consulting business—Responsible Investment Consulting Pty Ltd—and was delivered to the Government on 25 February 2010.[130]

4.46 The key findings of the independent review, as detailed in the Government's submission, were:

- that ACT Treasury had made considerable progress implementing the UN PRI since it had endorsed the Principles on 1 July 2008
- that ACT Treasury's approach had been methodical and thorough and has established a strong foundation for the future
- given the developmental nature of the UN PRI, that ACT Treasury had developed systems and processes to implement its commitments that were consistent with the practice of other PRI signatories, both in Australia and internationally, and
- ACT Treasury's approach to implementation of the PRI was considered to be both appropriate and sufficient.[131]

4.47 The Government advised that future UN PRI implementation activities are under consideration. These activities are summarised below. The

[129] Ms Katy Gallagher MLA, Select Committee on Estimates 2010–11, *Transcript of evidence*, 17 May 2010, p. 261.

[130] http://www.treasury.act.gov.au/documents/; Submission No. 5, March 2011, p. 17.

[131] *Ibid.*, pp. 17–18.

Committee understands that these activities pick up on recommendations of the independent review in respect of future action by the Government to further embed the requirements, or build capacity, for the continued implementation of the UN PRI.[132] Future UN PRI implementation activities under consideration include:

- increased participation in the PRI community through applicable forums, regular review of tools and services provided by the PRI in relation to their suitability and relevance to the Territory's responsible investment program, and future ongoing attendance at the PRI annual conference
- further development of management performance tools to assist in monitoring the implementation of the UN PRI, including additional Treasury employee training in relation to responsible investment
- better alignment between the Territory's company engagement program and dialogue with current investment managers
- a full review of current investment manager proxy voting policies and practices against international standards, as well as a review of the requirement for the appointment of a proxy voting service provider
- ongoing review of the SPA's ESG investment policy to ensure that it remains consistent with best practice and actual implementation practice
- inclusion of specialist responsible investment managers to manage the Territory's financial assets
- implementation of the PRI into other asset class investments of the Territory in addition to shares, and
- the appointment of an additional Investment Advisory Board member with specialist skills and experience in responsible investment practices.[133]

[132] Submission No. 5, March 2011, p. 18.

[133] *Ibid.*, pp. 19–20.

# 5 A POLICY BASED APPROACH TO DOING WELL BY DOING GOOD INVESTMENT

5.1 Notwithstanding the Committee's position as outlined in chapter two of this report, in the spirit of tri partisanship, the Committee has duly considered an alternative approach to strengthen the Government's investment framework with regard to the practice of 'doing well by doing good' investment. This alternative approach, along with a number of proposed recommendations, as a way forward, is framed within a policy context and is set out in this chapter.

5.2 In the context of proposing an alternative approach, the Committee has also considered evidence it received highlighting issues concerning the investment strategy and criteria as specified in the proposed Bill. This evidence is also discussed in this chapter.

## ACT Government investment portfolio

5.3 The Treasury Directorate, as at March 2011, manages approximately $3.3 billion in financial assets on behalf of the ACT Government. These financial assets include:

> …$2.2 billion in superannuation financial assets, held within the Superannuation Provision Account, and $1.1 billion in general government financial assets, held within the Territory Banking Account.[134]

5.4 The main objectives of the Government's investment portfolio with regard to the investment and management of these financial assets:

> …are to earn the Territory a competitive financial return, based on prudent financial and portfolio management principles, with an investment structure that is low cost, efficient to manage, and effective in deriving market-based returns.[135]

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[134] Submission No. 5, March 2011, p. 4.

[135] *Ibid.*

5.5 According to the Government, returns on its financial investment assets have contributed approximately $0.5 billion in investment revenues.[136]

5.6 The Government has obligations to its public beneficiaries—the ACT community—to act in its best interests. This requires the pursuit of its stated investment objectives to be 'undertaken with prudence (diversification and appropriate risk-taking) and professionalism'.[137]

5.7 The Government submitted that the new section proposed in the Bill relating to prioritising investment amounts in a defined ethical investment for superannuation banking accounts was effectively already the practice. The Government stated:

> The current Bill, as supported by the Explanatory Statement, states that where there is no substantive evidence of the potential for a reduced return between competing investments, the 'defined ethical investment' will need to be prioritised.
>
> The course of action prescribed by the draft Bill is arguably no different to the current investment practices of the Territory. The Territory's investment managers undertake relative risk and return analysis before an investment selection is made; the most superior investment on a relative basis is selected, which can already include companies involved in a defined ethical activity as outlined in the Bill.[138]

5.8 The Bill, if fully or partly passed by the Assembly, will signal a significant change to the ACT Government's current investment practices.

# Proposed investment criteria and strategy

## Investment strategy

5.9 The investment strategy specified by the proposed Bill is an exclusion-based or a negative screening strategy. The Committee was told:

> The bill, as it is written, is what I would call a negative screen. It is common to have on the other side of that a positive screen.
>
> …

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[136] Submission No. 5, March 2011, p. 4.

[137] *Ibid.*, p. 5.

[138] *Ibid.*, p. 25.

> There are things that I think you can screen and there is a larger set of things where I think you can very reasonably mandate shareholder advocacy.[139]

5.10 According to the literature, negative screening strategies date back to the early days of the practice of 'doing well by doing good' investment, in particular:

> The negative screening approach goes back to the early days…when companies of so-call "sin industries" (such as alcohol, tobacco or weapon/armament industries) were excluded from investment decisions…This approach was primarily applied by religious groups who did not wish to invest in such industries, as they felt that the business of these companies conflicted with their religious principles.[140]

5.11 In considering the overarching investment strategy—ethical exclusions or negative screening—as specified in the proposed Bill, evidence to the Committee emphasised the importance of being clear about what objectives an investor is trying to achieve by an ethical exclusion investment strategy:

> The matter of ethical exclusions is another matter. It goes to what the objectives of the government are in putting those negative screens in place in the investment process. So that would be more of a question to you as to what the belief was about the outcomes that could be achieved through negative screens.[141]

5.12 Regnan—GRE submitted:

> We feel that negative screening does have an important role to play and can be effective in some cases, but our central point is that on the whole we believe that any such screening needs to be situated within a wider context of responsible investment practices rather than forming the core of these.[142]

5.13 Furthermore, Regnan—GRE strongly advanced that it views:

> ...exclusion-investing as offering a limited means by which to address responsible investment considerations within a portfolio, and considers that its role in a portfolio should be limited.[143]

5.14 Some evidence emphasised that ethical exclusions or negative screening

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[139] Mr Howard Pender, *Transcript of evidence*, 22 March 2011, p. 11; 18

[140] Steurer, R., Margula, S. and Martinuzzi, A. (2008) *Socially Responsible Investment in EU Member States: Overview of government initiatives and SRI experts' expectations towards governments—Final Report to the EU High-Level Group on CSR*, European Commission, Research Institute for Managing Sustainability, Vienna University, April, p. 11.

[141] Ms Louise O'Halloran, *Transcript of evidence*, 7 July 2011, p. 67.

[142] Ms Peres Da Costa, *Transcript of* evidence, 5 July 2011, p. 28.

[143] Submission No. 6, March 2011, p. 3.

investment strategies were earlier innovations in 'doing well by doing good' investment, that in the main restricted the autonomy of the investor by limiting diversification together with limiting influence on the practices of excluded companies. This position is also supported by the literature as detailed in chapter two of this report.[144]

5.15 More contemporary views, on 'doing well by doing good' investment, which are also supported by the literature, advocate that investment strategies focused on engagement and integration are more appropriate for giving effect to an investor's desire to 'do good whilst doing well'. These strategies are particularly pertinent in the case of institutional investors. Regnan emphasised this view, in that:

> …vigorous participation in UNPRI-identified activities – particularly in collaboration with other investors – offers stronger potential for improved ESG outcomes than does the exclusion-based investing stipulated by the Bill. For these reasons, Regnan sees exclusion-investing as offering a limited means by which to address responsible investment considerations within a portfolio, and considers that its role in a portfolio should be limited.[145]

5.16 The Executive Director of Australian Ethical Investment Limited urged the Committee, in addition to determining which screened activities and investments would have widespread support from the ACT community, to consider mandating a level of ACT involvement in shareholder advocacy. Mr Pender commented:

> I would strongly encourage you, as members of this committee—if there are particular issues where there is widespread support for action on an issue but it does not extend to screening out companies, then think about mandating a level of ACT involvement in shareholder advocacy.[146]
>
> ...I think you should amend this bill as it sits at the moment. I think you should agree amongst yourselves where you think that screening is appropriate, and I think there is no question there are some areas where it is, but I can imagine that amongst yourselves you will disagree, pleasantly, where it is not. But I think there is a far broader set of situations where advocacy is appropriate and advocacy does not raise the issue of returns. There is no change. People still hold

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[144] Submission No. 6, March 2011, p. 2; *Transcript of evidence* 5 July 2011; *Transcript of evidence*, 7 July 2011.

[145] Submission No. 6, March 2011, p. 2.

[146] Mr Howard Pender, *Transcript of evidence*, 22 March 2011, p. 5.

> the companies. They do not change their portfolio weightings. They just say: "Okay, I accept I am going to own this company. I am not entirely happy with things it does. I am going to be a vocal person for change, supporting change, resolving proposed changes." I think you should add stuff like that to the bill as it is...[147]

5.17 The Committee understands that shareholder advocacy, by definition, does not affect an investor's rate of return because you are holding the same set of companies, whereas screening can potentially have a bearing on return. It is about being a responsible owner which is consistent with the UN PRI and does not alter an investor's portfolio.[148]

5.18 Some evidence to the Committee highlighted concerns with regard to precisely defining terms in the proposed Bill and the flow on effect this would have in terms of the availability of market information for assessment and compliance.[149] The Government stated:

> Due to many of the guidelines proposed in the Bill not being capable of precise legal definition (i.e. alleviation of poverty) and, in many cases, there is insufficient market information available, there is no certainty that investment decisions would be legally compliant. The explanatory statement accompanying the Bill is also deficient in guidance as to the interpretation and practical application of key requirements.[150]

5.19 Whilst the Government was not supportive of the proposed Bill *per se*, due to the extent of the investment prohibitions and prioritisations, together with the potential investment risk and cost implications[151], it submitted that it would support consideration of the:

- application of a negative screen (investment prohibition) to a limited number of industries being applied to the actively-managed share portfolios only
- application of a positive screen (investment prioritisation) with an allocation of the Territory's private equity program to target investment in environmental technologies, and
- appointment of additional or future equity investment managers that are specialists in responsible investing strategies.[152]

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[147] Mr Howard Pender, *Transcript of evidence*, 22 March 2011, pp. 8–9.

[148] *Ibid.*, p. 4.

[149] Submission No. 5, March 2011; Mr Scott Donald, *Transcript of evidence*, 2 August 2011; Submission No. 1, November 2010.

[150] Submission No. 5, March 2011

[151] Submission No. 5, March 2011; *Transcript of evidence*, 7 July 2011.

[152] Submission No. 5, March 2011, p. 30.

5.20 The Committee is of the view that exclusion-based or negative screening should not form the principal strategy of action to give effect to responsible investment. Rather, if it is used at all, it should be situated within a wider context of the responsible investment practices of engagement and integration in the context of public policy.

RECOMMENDATION 4

5.21 **The Committee recommends that the ACT Government, as an institutional investor should actively pursue a policy of responsible investment with selective use of exclusion-based or negative screening strategies in the context of public policy.**

## Investment criteria and materiality thresholds

5.22 The investment criteria specified by the Bill identify and prohibit the investment of government funds across a number of specified industries or activities using a materiality threshold of five per cent.

5.23 In commenting on the investment strategy and criteria as detailed in the Bill, a witness stated:

> …what you are doing I think you are much more prescriptive than many of the initiatives that I have seen in the last decade in Australia around things like sustainable investing and so on. That is not to say that is a bad thing; it is just to point out that there are a bunch of folks promoting responsible investment practices and responsible investment products.[153]

5.24 The Government commented that the criteria were restrictive and would be challenging to comply with:

> Many of the investment limitation and obligation guidelines proposed in the Bill are not capable of precise legal definition which makes the implementation and subsequent compliance difficult to achieve with any degree of confidence or certainty. Without such certainty it is not appropriate to enact legislation.[154]

5.25 In evidence, the Treasurer further emphasised:

> As I understand it, chair, there are numerous difficulties associated with the arms-length elements of management of our investments. The issues associated with the draft list, as presented in the exposure draft, and thresholds in relation

[153] Mr Scott Donald, *Transcript of evidence*, 2 August 2011, p. 88.

[154] Submission No. 5, March 2011, p. 5.

> to what level of interest or activity a particular company may have in those areas that are identified, would at times be difficult to ascertain. There are obvious philosophical questions in relation to the purpose of the government's investments in this area. My view is that our investments are here to fund our superannuation requirements and to seek to ensure that we achieve the targets that we have set in fully funding those obligations, and that this is a political distraction from that.[155]

5.26 Some submitters raised concerns with regard to the inclusion of the specified investment criteria in the Bill *per se*, i.e., the prescriptive nature of the Bill. These submitters suggested that conventional practice would be to detail the investment criteria in accompanying guidelines or delegated legislation.[156] A witness explained:

> I have a question around why the list is included directly in the legislation rather than inserted into guidelines, to become a disallowable instrument. Very commonly, I think lists such as this can appear as guidelines or in some other form of delegated legislation rather than directly like this.[157]

5.27 Whilst providing flexibility for amendments needed in the future, this recommended practice also provides a safeguard for responding to unintended or unforeseen consequences. For example:

> What you do not want to have happen is for something like this to be placed in legislation and, down the track at some point, unanticipated now but in five years time, it transpires that something is working in a way that is quite dysfunctional but cannot easily be redressed or cannot easily be changed. In a private law context, the parties could get together and agree to amend the contract or whatever, but the legislative cycle being what it is, it could end up being quite dysfunctional.[158]

5.28 The Committee discussed in some detail with witnesses the five per cent materiality threshold. The Committee understands that materiality thresholds can range from zero to five, five to ten and up to 33 per cent of revenue and that various investors will have different levels of sensitivity about the levels they set for their investment.[159] A witness explained:

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155 Mr Andrew Barr MLA, *Transcript of evidence*, 7 July 2011, p. 42.

156 Ms Susheela Peres Da Costa, *Transcript of evidence*, 5 July 2011, p. 36; Mr Scott Donald, *Transcript of evidence*, 2 August 2011, p. 80.

157 Mr Scott Donald, *Transcript of evidence*, 2 August 2011, p. 80.

158 *Ibid.*, p. 83.

159 Mr Duncan Paterson, *Transcript of evidence*, 22 March 2011, p. 25.

> There are other criteria areas where revenue thresholds are not appropriate. If you look at the issue of controversial weapons, for instance, there are very few companies globally who would make any more than one per cent of revenue from components for controversial weapons. Pornography is an issue which we cover for some church-based clients. There is no company, to my knowledge, that is listed globally that makes more than one per cent of revenue from direct involvement in the production of pornography.
>
> So it does depend on the nature of the client and the degree of sensitivity they have. Our work is based on the notion that we do not say what is a good or a bad company. We work with the client and identify what the client's sensitivity thresholds are.[160]

5.29 The Committee was interested to know what the industry would consider as an appropriate materiality threshold for a government, as an institutional investor, and was told that five per cent was quite significant and would exclude a large number of companies. A witness elaborated:

> I would say that generating more than five per cent of revenue from all of the activities in the legislation would knock off a lot of companies, and it is quite a strong threshold. The AMP responsible investment leaders product, for instance, uses 10 per cent as their materiality threshold...
>
> It is not unreasonable to use a threshold of five per cent, but it would depend on the number of criteria that you are choosing to use. We do have clients who would use five per cent as a materiality threshold, but they probably would not have as many criteria as are in the legislation, across as many industries. We do have clients who use a zero materiality threshold.
>
> ...one of the difficulties of picking a definition with a materiality threshold is that you have perverse outcomes. For instance, I gave the example of cluster munitions. I know that some of the publicity that has been around in the past around investments by the ACT has been involved with weapons manufacture. Five per cent probably would not catch some of those companies. So if you do pick a very simple materiality threshold-based approach, it has strong advantages because it is easy to communicate what you are doing but it has disadvantages because inevitably it will have some perverse outcomes. So you will have companies that make less than five per cent of revenue from tobacco, for instance; they may be the largest tobacco manufacturer in a country, but globally they make less than five per cent.[161]

5.30 The Government raised issues concerning the five per cent revenue

[160] Mr Duncan Paterson, *Transcript of evidence*, 22 March 2011, p. 25.

[161] *Ibid.*, p. 26.

limitation on prohibited activities and industries. This included difficulties in determining a company's revenue allocation at the specified threshold from activities on an historic basis due to limited public disclosure of required information and the timeliness of available information. Furthermore, the Bill complicates this issue by proposing that a determination of a company's revenue allocation from a particular business activity be made on a prospective basis (i.e., the financial year ahead). The Government emphasised that:

> This information would be almost impossible to obtain in a timely and accurate manner and, as a result, it would be necessary to exclude any company from investment where it was determined to derive any revenue at all from a prohibited activity and the Treasurer/Chief Executive was unable to satisfy herself or himself that such revenues were 5 per cent or less of total revenue.
>
> The Bill provides that the revenue proportionality assessment be determined by a 'reasonable grounds test'. In many instances there will always be an inability to determine the revenue percentage and therefore on this basis, the most likely scenario would be to exclude the particular company because of the uncertainty. The impact of this approach will be a smaller and less diversified investible universe.
>
> The specification of a 5 per cent revenue threshold is arbitrary and, even with this low revenue threshold, outcomes could still be contradictory to intentions, such as an armaments manufacturer that receives less than 5 per cent of revenue from the sale of cluster munitions or land mines being an approved investment. The legislation, as drafted, could also potentially lead to undesirable and/or unintended outcomes and consequences for the management of the Territory's financial assets, the extent to which is unknown and unquantifiable until full implementation of requirements to comply with any legislation commences.[162]

5.31 As to appropriateness of a five per cent materiality threshold, as specified in the proposed Bill, and its potential to impact on returns, the Executive Director of Australian Ethical Investment Limited commented:

> The question that we are sitting here today to ask is: how could the ACT be a socially responsible ethical investor if it wanted? I think the first answer is by passing the proposed screening bill which is on the table. The immediate question is: is it going to affect the returns? That is the first question people will ask. I think if the screening bill that I have seen was passed it would be pretty

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[162] Submission No. 5, March 2011, pp. 22–23.

> unlikely that it would affect international returns. Screening is not severe enough.
>
> With the exception of one criterion, I do not think it would affect Australian returns. There is one criterion, which is the "mining processing or sale of coal or extraction of oil".[163]

5.32 The Committee also heard from the Assembly's Ethics and Integrity Adviser with regard to the materiality threshold, as specified in the proposed Bill, that:

> For example, the provision allowing investment in prohibited investments below a certain threshold appears to suggest that it is permissible to be a little bit unethical. I consider that, as a matter of public policy, that concept should not be countenanced.[164]

5.33 The Committee notes the difficulties that arise with screening instruments for governments as institutional investors, in particular determining a type of screen acceptable to the wider community.

5.34 The Committee also discussed the feasibility of norms-based investment criteria drawn from and aligned with the various pronouncements made or supported by the Government and on which it actively campaigns—as potentially forming the Government's statement of ethics—for example, the ACT Government has an anti-tobacco campaign, an anti-liquor campaign, and a carbon dioxide reduction campaign.[165]

5.35 The Committee is of the view that the ACT Government, as an institutional responsible investor, should ensure that its nominated investment criteria are representative of the community it serves. As discussed earlier in this report, norms-based investment criteria are the most appropriate means by which governments, as institutional investors, can do this as they are founded on universally agreed and accepted principles.

## Fiduciary responsibilities

5.36 Whilst the ACT Government does not run a superannuation fund *per se* and

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[163] Mr Howard Pender, *Transcript of evidence*, 22 March 2011, pp. 3–4.

[164] Submission No. 1, November 2010, p. 1.

[165] *Transcript of evidence*, 22 March 2011, p. 16.

thus does not have, in absolute terms, what would be called a fiduciary obligation to potential superannuants, it does have a duty to ensure that all of the liabilities that have been incurred since 1989 are paid to its employees.[166]

5.37 The Committee is of the view that governments as institutional investors must ensure that their investments, whether they be in the form of superannuation contributions or public funds, reflect the views and values of the respective communities they serve. This is on the basis that governments have an obligation to act in the best interests of the beneficiaries of their investment decisions.

## Unintended consequences

5.38 In evidence, witnesses highlighted a number of unintended consequences associated with the investment criteria and strategy as specified by the proposed Bill. The major consequences pertinent to the object of the Bill are discussed below.

5.39 Some evidence argued that there was potential for unintended consequences detrimental to the wider UN PRI/responsible investment agenda to which the Government is a signatory. Evidence to the Committee suggested that the exclusion-based investment or negative screening, as prescribed in the proposed Bill, could detract or hamper collective responsible investment initiatives. Furthermore, the proposed Bill's investment strategy and criteria could lead to a focusing of investment efforts in an exclusion-based paradigm at the expense of a positive influence on social and environmental outcomes that can be achieved via engagement strategies. Regnan—GRE explained:

> Collaborative initiatives like company engagement are strengthened by the number of owners participating, the proportion of the entity they own and by the collective funds they represent within the market. Non-ownership of a stock prevents a responsible investor from lending their weight to ESG initiatives, thereby reducing the initiative's likelihood of success.[167]

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[166] *Transcript of evidence*, 7 July 2011, pp. 51-52.

[167] Submission No. 6, March 2011, p. 3.

5.40 The Committee is of the view that the investment strategy and criteria as specified in the proposed Bill could be counterproductive to the objectives of the UN PRI and the work to date by the Government as a responsible investor.

5.41 Furthermore, unintended consequences of exclusion-based investing could potentially lead to outcomes that may be counterproductive to the overarching responsible investment objective considered to be contemporary practice for institutional investors. Regnan—GRE explained:

> Avoidance of certain classes of company by a minority of investors generally has limited positive impact on those companies' practices. However, widespread, boycotts by the investment community could conceivably result in unintended consequences unhelpful to the wider environmental and social objectives. Examples include:
>
> - Concentrating ownership of excluded companies and industries in the hands of those investors with the least interest in environmental, social or corporate governance (ESG) resulting in poorer oversight and influence over these activities and practices;
> - Increasing the cost of capital to companies needing to invest in improved ESG characteristics (e.g., carbon abatement R&D).
> - Greater pressure on an excluded company that has no revenue-generating alternatives (e.g., coal mine, gaming company) than on a company that profits from excluded activities despite having alternatives (e.g., the same company's banker or conglomerate owner).[168]

5.42 The Committee also heard evidence of potential for unintended consequences, in the form of capturing activities more broadly than contemplated by the prescribed activities and industries.[169] For example, a witness explained:

> One of the observations I would make of these sorts of provisions and the challenges that they pose in practice around the world is that they can have unintended outcomes...I do observe that some of the definitions potentially capture activities more broadly than are intended. For instance, with the reference to revenue coming from things like genetically modified crops or the manufacture or sale of products that are produced using intensive animal farming, I wonder whether that would potentially capture things like major

[168] Submission No. 6, March 2011; *Transcript of evidence*, 5 July 2011.

[169] Mr Howard Pender, *Transcript of evidence*, 22 March 2011, p. 4; Mr Scott Donald, *Transcript of evidence*, 2 August 2011, p. 80; *Transcript of evidence*, 5 July 201.

> supermarkets or restaurant chains and so on where clearly the products that they sell may have those attributes, and whether that might not be what you are intending to achieve there—or maybe it is.
>
> Similarly, under the restriction on the manufacture or sale of arms or armaments, that might exclude companies like Boeing, and possibly some of the major software companies. I do not purport to be an expert in terms of Microsoft earnings these days but they do have very large defence contracts. So you may end up capturing in the net there some activities that are not anticipated.[170]

## Practical implications of implementing the proposed Bill

5.43 Evidence to the Committee highlighted a number of practical implications with regard to implementing the proposed Bill's investment strategy and criteria. These are discussed below.

### Implementation constraints—information and compliance

5.44 The Government advised that it had consulted with a range of investment service providers in the market to elicit views concerning the practical implications of managing the Territory's investment portfolio to ensure compliance with the proposed Bill.

5.45 A Treasury Directorate official elaborated:

> ...we have actually asked our incumbent funds managers to what extent they believe that they could invest a portfolio for us that fully complied with this legislation. They have told us that they would find it almost impossible to do that, because they would find difficulty in being able to drill down to the level of detail to get the information they need to decide whether, for example, five per cent or more of a company's revenue is involved in some of these activities. Certainly, they can probably do it for some companies. I guess the issue is all companies, to comply with the full list.[171]

5.46 The Committee understands that a key contributor to ensuring compliance is the availability of information to make the assessments required as part of the screening criteria and mandated materiality threshold. A Treasury Directorate official explained:

> How would we go about evaluating every company? Obviously we would have to go and buy that research from specialists to do that. In the conversations that

[170] Mr Scott Donald, *Transcript of evidence*, 2 August 2011, p. 80.

[171] Mr Patrick McAuliffe, *Transcript of evidence*, 7 July 2011, p. 46.

> we have had with a range of our current investment managers, what they are telling us is, "At the highest levels you can do some of this." I guess the risk is in trying to be too prescriptive in a legislative sense, but at a broader level, these things are done.
>
> The key difficulty that we have been informed about is the availability of information to make these assessments. There are many firms out there that do not actually publish every revenue line and those things so that you could actually drill down to that level of detail to make that decision. That is probably one of the biggest concerns—actually how you get that information."[172]

5.47 However, notwithstanding the Government's position, as above, other evidence from witnesses suggested that there were no impediments to availability of information.[173] With regard to claims concerning limitations on the availability of information, the Executive Director of the Responsible Investment Association Australasia stated:

> I would not agree that the information is not available. I think that sometimes there needs to be some clarity around the extent to which this can be taken, but if a negative screen is seen to be acting in the best interests of government and civil society and the outcomes are clearly identified then the research is certainly available. There are a number of leading providers covering the Australian stock market. I would say that that comment could not be justified.[174]

5.48 The Committee was interested to know whether there were any issues with the Government finding a fund manager or managers to implement the types of screens outlined in the Bill, both within Australia and also overseas. The Executive Director of Australian Ethical Investment Limited told the Committee:

> ...it is no issue at all. I even go further: absolutely no problem finding a fund manager. I know specialist asset consultants in the US and who operate in Australia who only deal in this sort of area as well. So you could easily find fund managers and relatively easily find asset consultants specialising in this area. So it just is not a problem.[175]

5.49 The Committee notes that witnesses with significant expertise and experience in the 'doing well by doing good' investment field were of the

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172 Mr Patrick McAuliffe, *Transcript of evidence*, 7 July 2011, p. 45.

173 Ms Louise O'Halloran, *Transcript of evidence*, 7 July 2011, p. 68; Mr Howard Pender, *Transcript of evidence*, 22 March 2011, p. 17.

174 Ms Louise O'Halloran, *Transcript of evidence*, 7 July 2011, p. 68.

175 Mr Howard Pender, *Transcript of evidence*, 22 March 2011, p. 17.

view that no information constraints would hamper implementation of the types of screens in the proposed Bill. However, these witnesses do not have an intimate knowledge of the Government's investment portfolio and on this basis, the advice from the Treasury Directorate regarding information constraints must also be given due consideration.

### Potential investment risk and cost—implications of the proposed Bill

5.50 The Government strongly advanced that the proposed Bill, if adopted, raised significant concerns in relation to: the potential increase in investment portfolio concentration risk; increased portfolio return volatility; a bias toward smaller companies and certain industries; long term investment capacity constraints; substantial one-off transaction costs in order to re-organise the financial assets; and an increase in ongoing investment management costs for the Territory's financial assets.[176]

5.51 In practice, the Government cautioned that the broad nature of the proposed Bill with regard to the prescribed investment prohibitions and obligations would not only have a significant and immediate impact on the ability of the Territory's investment managers to select suitable investments and construct appropriately diversified portfolios but also in terms of meeting current investment objectives.[177]

5.52 The Government explained that transitioning sizeable financial assets can incur significant costs and on this basis there must be a strong financial business case to warrant the significant restructure of the investment portfolio assets as would be required to ensure compliance with the proposed Bill. The Government estimated that the costs would:

> ...be in the order of $3.5 million to $4.7 million. Ongoing annual management costs could increase substantially, in the order of up to $11 million per annum, if the Territory was required to implement an appropriate ethical investment structure to attempt to meet the requirements of the Bill.[178]

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[176] Submission No. 5, March 2011, p. 5; pp. 25–26.

[177] *Ibid.*

[178] *Ibid.*

## Committee comment

5.53 The Committee has carefully considered the high quality submissions it received, and the evidence it heard. The Committee fully supports the concept of 'doing well by doing good' investment. The Committee notes that the Government has given effect to this form of investment practice via a responsible investment framework. The Committee is of the view that whilst governments, as institutional investors, have important roles to play in relation to responsible investment, they nonetheless have a bounded role, as compared with other types of institutional investors, by virtue of an obligation to act in the interests of the communities they serve. The bounded nature of this role is also more pronounced in a small government jurisdiction, such as the ACT, because of the limited avenues available to give effect to the practice of responsible investment, for example, the ACT Government is not a national government nor does it run a superannuation fund.

5.54 As detailed in this report, the Government has developed and implemented a policy of responsible investment to give effect to the practice of 'doing well by doing good' investment. In the main, it appears that the Government has implemented this policy intention by becoming a signatory to the UN PRI and publicly stating that it it will act in accordance with the UN PRI. Action undertaken by the Government since becoming a signatory to the UN PRI, together with future UN PRI implementation activities under consideration, were discussed in chapter four of this report.

RECOMMENDATION 5

5.55 **The Committee recommends to ensure consistency with recognised investment terminology, and to promote a common understanding, that the ACT Government's 'doing well by doing good' investment policy framework be referred to henceforth as—responsible investment.**

5.56 Whilst the Committee respects the many and varied opinions it considered during the course of the inquiry, it is of the view that the overarching framework in which the proposed Bill must be considered is in the context of the role of government in 'doing well by doing good' investment, specifically as an institutional investor. The Committee has discussed in this report the bounded nature of the role governments, as institutional investors, can play together with the limitations they face in determining representative investment criteria and appropriate investment strategies. In summary, governments should be taking a principled based approach to this form of investment, as opposed to the prescriptive approach detailed in the proposed Bill.

5.57 As stated in chapter two, the Committee does not support the proposed Bill. This is on the basis that:

- the proposed investment strategy—exclusion-based or negative screening—is not consistent with contemporary practice which favours a more proactive orientation that seeks to create change through engagement and integration
- the criteria specified represent a blanket ban approach more akin to an individual investor or a non-government institution or company with religious beliefs, or a defined purpose, for example, a catholic hospital, or articulated values congruent to a defined purpose
- the materiality thresholds for the criteria are severe and would make it very difficult to have a diversified portfolio
- the strategy and criteria are counterproductive to the Government's current 'doing well by doing good' investment policy of responsible investment, and
- the strategy and criteria are indicative of a prescriptive based approach which is contrary to the role that governments, as institutional investors, should be taking with regard to this form of investment.

5.58 Whilst the Committee does not support the proposed Bill it does support action to strengthen the Government's responsible investment framework. In the Committee's opinion, action to build capacity for this investment framework should be progressed on two fronts: (i) development of a responsible investment policy; and (ii) consistent with its commitment to the UN PRI, the Government should build its capacity to participate in public engagement and advocacy activities. Each of these recommended courses of action are discussed below.

### Development of a responsible investment policy

5.59 The Government advised that it had developed and implemented a responsible investment approach for application to the Territory's investment portfolio. The Committee believes that this approach could be strengthened by an accompanying responsible investment policy.

5.60 The Committee is of the view that the such a policy should specify a principled based approach to investment. In practice, the proposed policy should specify a principled approach to responsible investment, and to maintain transparency, require the Government to report annually on that policy to the Legislative Assembly. The annual reporting timeframe should also fall after the UN PRI mandatory annual reporting and assessment survey to harness reporting efficiencies and to avoid an unnecessary administrative burden on the Treasury Directorate.

RECOMMENDATION 6

5.61 **The Committee recommends that the ACT Government should develop a policy of responsible investment that reflects a principled based approach to this form of investment.**

5.62 The policy should set out principled based investment criteria for the Territory's investments that are consistent with internationally recognised norms and conventions relevant to responsible investment. The principled investment criteria, together with the UN PRI, should form the Government's investment criteria. Whilst the Government does not directly control its investments, the policy should require the Government to instruct its fund managers to invest according to these criteria. An annual reporting and disclosure requirement will ensure transparency with regard to the Territory's investments. More importantly, the Committee acknowledges that the investment policy should require that funds are not invested in ways that are inconsistent with the core business of the Territory's investment objectives.

5.63 Furthermore, with regard to reporting and disclosure requirements, the policy should adopt the Australian Stock Exchange's (ASX) corporate governance reporting requirements. ASX has corporate governance principles with which listed companies are required to comply. However, it uses an "if not, why not?" test. In practice, this means that companies not complying with certain principles must disclose why they have not complied. In evidence, the Head of ESG Services with Regnan—GRE commented:

> I think there is a lot of strength in the "if not, why not?" type of disclosure, which makes it incumbent upon the person opting not to make the expected decision to explain why not. It does allow them the flexibility to do so. So if you were to have within legislation the statement of principle as discussed, and then within policy explain what the accountability needed to be about meeting those principles, and allowing for an "if not, why not?" type of situation, I think that would be a good starting point for thinking about how you might be able to code a desire to express ethical investment principles.[179]

5.64 As the Committee has indicated earlier in its report, in the spirit of tri partisanship, it has duly considered an alternative approach to strengthen the Government's investment framework with regard to responsible investment. This approach, as a way forward, is framed within a policy context. In the main, it rests on the development of a proposed responsible investment policy that specifies the use of norms-based investment criteria for the Territory's investments with the use of engagement and integration investment strategies. As noted previously, consistent with other references and recommendations, the Committee is of the view that selective exclusion-based screening strategies consistent with the Government's articulated public policy context are permissible. However, the Committee does not support an investment policy entirely based on negatively screening or excluding companies.

5.65 As noted previously, in the case of governments, as institutional investors, norms-based investment criteria are considered more appropriate. Norms-based investment criteria or principled based investment criteria are essential for any form of responsible investment by governments. The basis for this is two-fold: (i) firstly, it acts as a safeguard against responsible investment practices becoming captured politically, for example, by not permitting a group of people to become sole arbiters of what should or should not be

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[179] Ms Susheela Peres Da Costa, *Transcript of evidence*, 5 July 2011, p. 36.

invested in. Norms-based criteria, as illustrated in the public pension funds profiled earlier in this report, rest on universally agreed and accepted principles, in the form of international standards, treaties and conventions; and (ii) are a means by which governments, as investors, can effectively represent the will of their public beneficiaries, in the form of superannuation investments, and more generally, via investment of financial resources on behalf of the public and to use these returns to fund public programs and long term policies and plans.

## RECOMMENDATION 7

5.66 **The Committee recommends that the implementation and reporting requirements for the proposed responsible investment policy be detailed in the policy. Amongst other things, the policy should:**

**a) set out norms-based investment criteria for the Territory's investments that are consistent with internationally recognised norms and conventions relevant to ethical investment and responsible investment and the ACT Government's status as a signatory to the United Nations Principles of Responsible Investment**

**b) in the main, use engagement and integration investment strategies supplemented by the selective use of exclusion-based screening strategies consistent with the ACT Government's articulated public policy context**

**c) require the ACT Government to instruct its fund managers to invest according to the specified norms-based investment criteria**

**d) specify an annual reporting and disclosure requirement to ensure transparency with regard to the Territory's investments. Reporting and disclosure requirements should use an "if not, why not?" test,**

**e) require that funds are not invested in ways that are inconsistent with the core investment objectives of the Territory, and**

**f) require the ACT Government to comply with the policy and report annually on it to the ACT Legislative Assembly.**

### Build capacity for public engagement and advocacy

5.67 Consistent with the UN PRI, amongst other things, signatories commit to:

- incorporating ESG issues into investment analysis and decision-making processes
- being active owners and incorporate ESG issues into ownership policies and practices, and
- appropriate disclosure on ESG entities in which they invest.[180]

5.68 Some evidence to the Committee advanced that the Government, as a responsible investor, should consider participation in collaborative active engagement strategies and increased disclosure with regard to its investing and engagement activities.[181]

5.69 Increased investor transparency is a key action advocated by the UN PRI and one which signatories commit to. The Committee is of the view that, as a responsible investor, coupled with its obligations to act in the interests of the ACT community, the Government should take action to increase transparency and ensure appropriate disclosure of the companies in which it holds shares and in which it has supported engagement activities.

5.70 Participation in collaborative active engagement is a defining strategy of responsible investors. It is focused on influencing the practices of companies and offers strong potential for improved ESG outcomes as compared with exclusion-based investing as prescribed by the proposed Bill. Furthermore, the Committee notes that this investment strategy does not affect returns and is consistent with the UN PRI.

5.71 The Committee is also of the view that consistent with its commitment to the UN PRI, the Government should build its capacity to participate in public engagement and advocacy activities. This would require the Government to engage with companies in which it invests and advocate for change on issues of concern to the ACT community.

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[180] www.unpri.org

[181] Submission No. 2, December 2010; Submission No. 6, March 2011; *Transcript of evidence*, 22 March 2011; *Transcript of evidence*, 5 July 2011.

5.72 The Committee does not support an investment policy entirely based on negatively screening or excluding companies.

5.73 The Committee understands that to some extent, the Government may be participating in engagement and advocacy activities. However, it appears that these activities are taking place behind the scenes. The Executive Director of Australian Ethical Investments submitted:

> We understand from the material on page 24 of the annual report of the ACT Treasury for 2008-09 the ACT Government may engage in this sort of activity "behind the scenes." We don't feel that is an appropriate way to use public money. In our view the situation of a government involved in this activity is fundamentally different to that of a privately owned investment house.
>
> Government monies should be used in a clearly transparent manner. We suggest the Bill include additional provisions dealing with public advocacy.[182]

5.74 In support of this strategy—as offering strong potential for improved ESG outcomes—on the basis that collaborative engagement and advocacy can have significant influence on the practices of identified companies, Regan ESG emphasised:

> One of the key aspects of the UN principles for responsible investment, and I think one of its strengths, is actually the idea of collaboration. One of the six principles recognises that institutional investors working together can effect change in markets and within companies. They are actually quite a powerful agent. In some senses I guess I see it as a stepping aside from that duty as a responsible investor, to just say, "Oh well, we won't invest in these things," and just walk away from it rather than to try and exercise that influence.[183]

5.75 The Committee also notes the position advanced by the Government, for example, in the case of voting on shareholder resolutions, how resource intensive it would be to oversight every vote and prepare associated briefing material for the responsible Minister as to a recommended position on each and every voting right.[184] The Committee, however, believes that it would be reasonable for the Government to sponsor or co-sponsor public engagements and shareholder resolutions on matters of concern. The matters of concern should be drawn from the norms-based criteria to be set out in the proposed

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[182] Submission No. 2, December 2010.

[183] Ms Susheela Peres da Costa, *Transcript of evidence*, 5 July 2011, p. 31.

[184] *Transcript of evidence*, 7 July 2011, pp. 57–61.

responsible investment policy. The Government should report on this activity—companies engaged with and the issues involved—annually as part of the requirement to report on the responsible investment policy.

### RECOMMENDATION 8

5.76 **The Committee recommends that the ACT Government publish a list of the companies in which it holds shares, as part of the annual requirement to report on the proposed responsible investment policy.**

### RECOMMENDATION 9

5.77 **The Committee recommends that the ACT Government, as part of the proposed responsible investment policy, sponsor or co-sponsor public engagements and shareholder resolutions on matters of concern. The matters of concern should be drawn from the norms-based criteria to be set out in the Government's responsible investment policy. The Government should report on this activity—companies engaged with and the issues involved—as part of the annual requirement to report on the responsible investment policy.**

# 6 CONCLUSION

6.1 The Committee wishes to thank all of the organisations that, and individuals who, have contributed to its inquiry, by making submissions, providing additional information, and/or appearing before it to give evidence.

6.2 The Committee recognises the significant commitment of time and resources required to participate in an inquiry of this nature and is grateful that it was able to draw on a broad range of expertise and experience in its deliberations. The Committee notes that it has adopted many of the recommendations, or variations thereof, suggested by participants as recommendations for this report.

6.3 As noted previously, the ACT Government was the first government in Australia to become a signatory to the UN PRI. In becoming a signatory, the Government has committed to: (i) increase transparency with regard its investments; and (ii) incorporate ESG criteria into its mainstream investment decision making. The Committee has recommended a course of action that supports growth in the principled based approach to responsible investment, as taken by the Government. This approach, whilst building on achievements to date, puts the Government on notice that it should now be taking a stronger and more proactive stance with regard to responsible investment in the Territory. This course of action will minimise the risk of the Government being accused of, or criticised for, trading on its UN PRI signatory status.[185]

6.4 The Committee supports the continued progression of the ACT Government's commitment to the UN PRI. The Committee believes the recommendations it has made as part of this inquiry will assist with building capacity for this important investment framework.

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[185] *Transcript of evidence*, 22 March 2011, p. 16.

6.5 The Committee has made nine recommendations in relation to its inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010.

Brendan Smyth MLA

Inquiry Chair

1 December 2011

# APPENDIX A: Exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010

A copy of the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010, together with the explanatory statement, is attached.

**2010**

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

# FINANCIAL MANAGEMENT (ETHICAL INVESTMENT) LEGISLATION AMENDMENT BILL 2010

## EXPLANATORY STATEMENT

**Circulated by**
**Meredith Hunter MLA**

## OVERVIEW

The Bill amends the *Financial Management Act 1996* and the *Territory Superannuation Provision Protection Act 2000* to prohibit certain investments made under those Acts. The Bill also requires the investments made under the *Territory Superannuation Provision Protection Act 2000* to, where prudent, be prioritised in proscribed activities. The Bill adds to the current Section 11 of the *Territory Superannuation Provision Protection Act 2000* and Sections 38 and 58 of the *Financial Management Act 1996* that create the capacity for ACT investments. The Bill places new limitations and obligations on investments made under those sections.

The Bill sets out the prohibited investments and provides a maximum threshold of 5% of revenue, above which investment may not be made. This threshold recognises that entities will have a diverse range of investment streams and that investments in otherwise permissible activities should not be limited because of minor interests or revenue lines. This threshold is consistent with many commercial funds that offer ethical, responsible or sustainable, investment options.

The Bill also provides that funds invested under Section 11 of the *Territory Superannuation Provision Protection Act 2000* must be prioritised, where prudent, in a defined list of activities that are designed to achieve positive social and environmental outcomes.

The Bill builds on, and is complimentary to, the ACT's adoption of the UN Principles of responsible investment.

## HUMAN RIGHTS

The Bill does not engage any human rights. Sections 6 of the Human Rights Act 2004 sets out that only individuals have human rights. The Bill promotes the application of human rights issues to Territory investment practices and will only affect the activities of the Territory in regard to relevant bodies (as defined) and not individuals.

## REASONS FOR THE DELEGATION OF LEGISLATIVE POWER

The Bill delegates the ability to the Minister to set additional investment limitations and add additional investment priorities and provides that any such determination is a disallowable instrument. This limited delegation is considered reasonable and proportionate and allows a level of flexibility to respond to contemporary circumstances.

## SUMMARY OF CLAUSES

**Clause 1 Name of the Act**
This clause sets out the name of the proposed Act as the *Financial Management (Ethical Investment) Legislation Amendment Act 2010.*

**Clause 2 Commencement**
This clause sets out when commencement of the Act will occur. The Act will commence on 1 July 2011.

**Clause 3 Legislation amended**
This clause identifies the Act to be amended, namely the *Financial Management Act 1996* and the *Territory Superannuation Provision Protection Act 2000.*

**Clause 4 Investment of certain public money New section 38 (10)**
This clause inserts into Section 38 of the *Financial Management Act 1996* a requirement that investments made under the that section will now be subject to the new section 38A set out in clause 5.

**Clause 5 New section 38A**
This clause sets out the restrictions to be placed on investments made under Section 38.

Section 38A - **Restrictions on investment of certain public money** – The limitation on investments only applies to relevant bodies (as defined by the bill) where more than 5% of that body's revenue is attributable to a product or activity defined in subsection (2)(b).

In order for the prohibition to apply the Minister must believe on reasonable grounds that it is not likely that more than 5% of body's revenue for the current financial year will come from a listed product or activity. A body would not be a prohibited investment if they derive revenue from multiple categories provided that no more than 5% of their revenue can be attributed to any single category.

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.

Relevant bodies are defined by reference to the Corporations Act. Through this definition it is intended that both direct and indirect holdings or interests 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) that is excluded by section 38A (2) (a).

**Clause 6 Investment by territory authorities New section 58 (9)**

This clause inserts into section 58 of the *Financial Management Act 1996* a requirement that investments made under that section will now be subject to the new section 58A set out in clause 7.

**Clause 7 New Section 58A**

This clause applies to the investment of funds by Territory Authorities under section 58. The application of the clause is the same as clause 5 set out above.

**Clause 8 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 9 Investment of amounts in superannuation banking accounts New section 11 (7)**

This clause inserts into section 11 of the *Territory Superannuation Provision Protection Act 2000* a requirement that investments made under the that section are subject to the new sections 11A and 11B set out in clause 10.

This clause inserts into section 11 of the *Territory Superannuation Provision Protection Act 2000* a requirement that investments made under the that section are subject to the new sections 11A and 11B set out in clause 10.

This clause sets out the restrictions to be placed on investments made under Section 11.

New section 11A - **Prioritising investment of amounts in superannuation banking accounts** – The provision requires that investments must, where prudent, prioritise defined investments. 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.

The provision is designed to give the decision maker sufficient flexibility to ensure that decisions are prudent in the prevailing market conditions. Investment decisions made under section 11A are subject to the prohibitions in 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 *Financial Management Act 1996* by clause 5 above. It is intended to have the same application in the context of the *Territory Superannuation Provision Protection Act 2000.*

**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).

EXPOSURE DRAFT

(Prepared by Parliamentary Counsel's Office)

# Financial Management (Ethical Investment) Legislation Amendment Bill 2010

## A Bill for

An Act to amend the *Financial Management Act 1996* and the *Territory Superannuation Provision Protection Act 2000*

The Legislative Assembly for the Australian Capital Territory enacts as follows:

## Part 1 Preliminary

**1 Name of Act**

This Act is the *Financial Management (Ethical Investment) Legislation Amendment Act 2010.*

**2 Commencement**

This Act commences on 1 July 2011.

*Note* The naming and commencement provisions automatically commence on the notification day (see Legislation Act, s 75 (1)).

**3 Legislation amended**

This Act amends the *Financial Management Act 1996* and the *Territory Superannuation Provision Protection Act 2000.*



**EXPOSURE DRAFT**

## Part 2 Financial Management Act 1996

**4 Investment of certain public money**
**New section 38 (10)**

*insert*

(10) This section is subject to section 38A.

**5 New section 38A**

*in part 5, insert*

**38A Restrictions on investment of certain public money**

(1) The Treasurer must not invest any money held in the territory banking account or departmental banking accounts in a prohibited investment.

(2) An investment is a ***prohibited investment*** if—

(a) it includes investment in a relevant body; and

(b) the Treasurer is not satisfied on reasonable grounds that 5% or less of the relevant body's revenue for the current financial year is likely to be attributable to any 1 of the following activities:

(i) the manufacture or sale of liquor;

(ii) the manufacture or sale of tobacco;

(iii) the manufacture or sale of arms or armaments, their components or software;

(iv) the manufacture or sale of gaming equipment, its components or software;

(v) the operation of gambling facilities;

(vi) the mining, processing or sale of uranium;

(vii) the mining, processing or sale of coal;

(viii) the extraction, processing or sale of crude oil;

(ix) the manufacture or sale of timber products, including paper, that are produced using timber harvested from—

(A) native old-growth forests; or

(B) plants protected under the *Nature Conservation Act 1980* or a law of another Australian or foreign jurisdiction corresponding to that Act;

(x) genetically modified agricultural crops;

(xi) the manufacture or sale of products that are produced using intensive animal farming;

(xii) the manufacture or sale of cosmetics that are produced using animal testing;

(xiii) the manufacture or sale of products that are produced using labour in breach of any international treaty or other international agreement, in relation to labour and child labour, to which Australia is a party;

(xiv) an activity declared by the Minister under subsection (3).

(3) The Minister may declare an activity for subsection (2) (b) (xiv).



**EXPOSURE DRAFT**

(4) A declaration is a disallowable instrument.

*Note* A disallowable instrument must be notified, and presented to the Legislative Assembly, under the Legislation Act.

(5) If the Treasurer becomes aware that an investment has become a prohibited investment, the Treasurer must divest the Territory of the investment as soon as reasonably practicable.

(6) In this section:

***gaming equipment***—see the *Gambling and Racing Control Act 1999*, dictionary.

***investment***, in a relevant body—

(a) means investment within the meaning of the Corporations Act, section 9; but

(b) does not include a term deposit, bond or similar investment in an authorised deposit-taking institution.

***liquor***—see the *Liquor Act 2010*, dictionary.

***relevant body*** means—

(a) a company registered under the Corporations Act; or

(b) a disclosing entity under the Corporations Act; or

(c) a body under the Corporations Act; or

(d) a registered scheme under the Corporations Act.

**6 Investment by territory authorities**
**New section 58 (9)**

*insert*

(9) This section is subject to section 58A.

**7 New section 58A**

*insert*

**58A Restrictions on investment by territory authorities**

(1) A territory authority must not invest funds of the authority in a prohibited investment.

(2) An investment is a ***prohibited investment*** if—

(a) it includes investment in a relevant body; and

(b) the territory authority is not satisfied on reasonable grounds that 5% or less of the relevant body's revenue for the current financial year is likely to be attributable to any 1 of the following activities:

(i) the manufacture or sale of liquor;

(ii) the manufacture or sale of tobacco;

(iii) the manufacture or sale of arms or armaments, their components or software;

(iv) the manufacture or sale of gaming equipment, its components or software;

(v) the operation of gambling facilities;

(vi) the mining, processing or sale of uranium;

(vii) the mining, processing or sale of coal;

(viii) the extraction, processing or sale of crude oil;

(ix) the manufacture or sale of timber products, including paper, that are produced using timber harvested from—

(A) native old-growth forests; or



**EXPOSURE DRAFT**

(B) plants protected under the *Nature Conservation Act 1980* or a law of another Australian or foreign jurisdiction corresponding to that Act;

(x) genetically modified agricultural crops;

(xi) the manufacture or sale of products that are produced using intensive animal farming;

(xii) the manufacture or sale of cosmetics that are produced using animal testing;

(xiii) the manufacture or sale of products that are produced using labour in breach of any international treaty or other international agreement, in relation to labour and child labour, to which Australia is a party;

(xiv) an activity declared by the Minister under subsection (3).

(3) The Minister may declare an activity for subsection (2) (b) (xiv).

(4) A declaration is a disallowable instrument.

*Note* A disallowable instrument must be notified, and presented to the Legislative Assembly, under the Legislation Act.

(5) If a territory authority becomes aware that an investment has become a prohibited investment, the authority must divest itself of the investment as soon as reasonably practicable.

(6) In this section:

***gaming equipment***—see the *Gambling and Racing Control Act 1999*, dictionary.

***investment***, in a relevant body—

(a) means investment within the meaning of the Corporations Act, section 9; but

(b) does not include a term deposit, bond or similar investment in an authorised deposit-taking institution.

***liquor***—see the *Liquor Act 2010*, dictionary.

***relevant body*** means—

(a) a company registered under the Corporations Act; or

(b) a disclosing entity under the Corporations Act; or

(c) a body under the Corporations Act; or

(d) a registered scheme under the Corporations Act.

**8 Dictionary, note 2**

*insert*

- Corporations Act



**EXPOSURE DRAFT**

# Part 3 Territory Superannuation Provision Protection Act 2000

**9 Investment of amounts in superannuation banking accounts**
**New section 11 (7)**

*insert*

(7) This section is subject to section 11A and section 11B.

**10 New sections 11A and 11B**

*insert*

**11A Prioritising investment of amounts in superannuation banking accounts**

(1) In deciding how to invest an amount in a superannuation banking account under section 11, the chief executive must, if satisfied it is prudent, give priority to investing in a defined ethical investment over another investment.

(2) An investment is a ***defined ethical investment*** if it includes investment in any 1 of the following activities:

(a) the generation of renewable energy;

(b) energy efficiency and reduction of greenhouse gas emissions;

(c) water conservation;

(d) environmental reporting and remediation;

(e) pollution control and chemical replacement;



**EXPOSURE DRAFT**

(f) waste management and recycling;

(g) education, including the development and supply of educational products and services;

(h) the development of sustainable and social housing;

(i) health and safety improvement and management;

(j) the alleviation of poverty;

(k) charitable and community support programs;

(l) the modification of products and provision of services to improve disabled access;

(m) the provision of services in a way that promotes social inclusion;

**Example—services**

banking services

*Note* An example is part of the Act, is not exhaustive and may extend, but does not limit, the meaning of the provision in which it appears (see Legislation Act, s 126 and s 132).

(n) the provision of public transport;

(o) an activity declared by the Minister under subsection (3).

(3) The Minister may declare an activity for subsection (2) (o).

(4) A declaration is a disallowable instrument.

*Note* A disallowable instrument must be notified, and presented to the Legislative Assembly, under the Legislation Act.



**EXPOSURE DRAFT**

### 11B Restrictions on investment of amounts in superannuation banking accounts

(1) The chief executive of the superannuation department must not invest an amount in a superannuation banking account in a prohibited investment.

(2) An investment is a ***prohibited investment*** if—

(a) it includes investment in a relevant body; and

(b) the chief executive is not satisfied on reasonable grounds that 5% or less of the relevant body's revenue for the current financial year is likely to be attributable to any 1 of the following activities:

(i) the manufacture or sale of liquor;

(ii) the manufacture or sale of tobacco;

(iii) the manufacture or sale of arms or armaments, their components or software;

(iv) the manufacture or sale of gaming equipment, its components or software;

(v) the operation of gambling facilities;

(vi) the mining, processing or sale of uranium;

(vii) the mining, processing or sale of coal;

(viii) the extraction, processing or sale of crude oil;

(ix) the manufacture or sale of timber products, including paper, that are produced using timber harvested from—

(A) native old-growth forests; or



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(B) plants protected under the *Nature Conservation Act 1980* or a law of another Australian or foreign jurisdiction corresponding to that Act;

(x) genetically modified agricultural crops;

(xi) the manufacture or sale of products that are produced using intensive animal farming;

(xii) the manufacture or sale of cosmetics that are produced using animal testing;

(xiii) the manufacture or sale of products that are produced using labour in breach of any international treaty or other international agreement, in relation to labour and child labour, to which Australia is a party;

(xiv) an activity declared by the Minister under subsection (3).

(3) The Minister may declare an activity for subsection (2) (b) (xiv).

(4) A declaration is a disallowable instrument.

*Note* A disallowable instrument must be notified, and presented to the Legislative Assembly, under the Legislation Act.

(5) If the chief executive of the superannuation department becomes aware that an investment has become a prohibited investment, the chief executive must divest the Territory of the investment as soon as reasonably practicable.

(6) In this section:

***gaming equipment***—see the *Gambling and Racing Control Act 1999*, dictionary.



**EXPOSURE DRAFT**

***investment***, in a relevant body—

(a) means investment within the meaning of the Corporations Act, section 9; but

(b) does not include a term deposit, bond or similar investment in an authorised deposit-taking institution.

***liquor***—see the *Liquor Act 2010*, dictionary.

***relevant body*** means—

(a) a company registered under the Corporations Act; or

(b) a disclosing entity under the Corporations Act; or

(c) a body under the Corporations Act; or

(d) a registered scheme under the Corporations Act.

**11 Dictionary, note 2**

*insert*

- Corporations Act

## Endnotes

**1 Presentation speech**

Presentation speech made in the Legislative Assembly on 2010.

**2 Notification**

Notified under the Legislative Act on 2010.

**3 Republications of amended laws**

For the latest republication of amended laws, see www.legislation.act.gov.au.

# APPENDIX B: List of written submissions

Written submissions received by the Committee:

| | |
|---|---|
| No. 1 | Mr Stephen Skehill SC—Ethics and Integrity Adviser to MLAs |
| No. 2 | Australian Ethical Investment Limited |
| No. 2a | Australian Ethical Investment Limited |
| No. 3 | CAER—Corporate Analysis. Enhanced Responsibility |
| No. 4 | Standing Committee on Justice and Community Safety (performing the duties of a Scrutiny of Bills and Subordinate Legislation Committee) |
| No. 5 | ACT Government |
| No. 6 | Regnan—Governance Research and Engagement |

# APPENDIX C: Committee public hearings

List of witnesses who appeared before the Committee at public hearings:

**Public hearing of Tuesday 22 March 2011**

- Mr Howard Pender, Executive Director, Australian Ethical Investement Limited
- Mr Duncan Paterson, private individual

**Public hearing of Tuesday 5 July 2011**

- Ms Susheela Peres Da Costa, Head of ESG Services, Regnan Governance Research and Engagement
- Ms Amanda Wilson, Acting Manager Director, Regnan Governance Research and Engagement

**Public hearing of Thursday 7 July 2011**

- Mr Andrew Barr MLA, Treasurer
- Mr Roger Broughton, Executive Director, Investment and Economics Division, Treasury Directorate
- Ms Megan Smithies, Under Treasurer, Treasury Dircetorate
- Mr Patrick McAuliffe, Director, Investment Branch, Investment and Economics Division, Treasury Directorate
- Ms Louise O'Halloran, Executive Dircetor, Responsible Investment Association Australasia

**Public hearing of Tuesday 2 August 2011**

- Mr Scott Donald, Faculty of Law, University of NSW

# APPENDIX D: 246A Statement to the ACT Legislative Assembly (28 October 2010)

**Statement pursuant to Standing Order 246A
relating to the
Exposure draft of the Financial Management (Ethical Investment)
Legislation Amendment Bill 2010**

Pursuant to Standing Order 246A, I wish to make a statement on behalf of the Standing Committee on Public Accounts relating to the Committee's inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010.

At its meeting on Wednesday 22 September 2010, the Legislative Assembly passed the following resolution:

> That the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill be referred to the Standing Committee on Public Accounts for inquiry and report.

I wish to inform the Assembly as to how the Standing Committee on Public Accounts has determined and agreed to progress its inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill.

It is on the public record that I hold 4.98% of the shares in Australian Ethical Investment and I was an executive director of Australian Ethical Investment for 17 years. Australian Ethical Investment is an ASX listed company based in Canberra that is a retail funds manager specialising in ethical investments.

Since the first meeting at which the Committee considered the Referral, it has carefully reflected on and discussed whether there is any possible (real or perceived) conflict of interest by a Member in the inquiry. As part of this process I also provided advice, which I had previously sought, to the Committee from the Assembly's Ethics Advisor indicating that, in his opinion, no conflict of interest existed.

The Committee has unanimously agreed that no Member has a real conflict of interest. The Committee came to this conclusion because no recommendations of the Committee could directly cause investment changes by the ACT Government or any other entity. The Committee also believes that even if the Legislative Assembly was to fully or partly pass the Financial Management (Ethical Investment) Legislation Amendment Bill 2010 then there is no reason to believe that I would benefit financially from that decision.

However, to avoid any possible perception of a conflict of interest, I, as the Chair of the Committee, offered to relinquish this role for the purposes of this inquiry and the Deputy Chair has agreed to chair the inquiry.

The Committee is aware of Standing Order 224 – Pecuniary interest which states that: '*A Member may not sit on a committee if that Member has any direct pecuniary interest in the inquiry before such committee'*.

The Committee has also carefully considered the requirements of Standing Order 224 and has unanimously resolved that my participation in the inquiry would not contravene Standing Order 224.

The Committee will be calling for submissions to its inquiry shortly and is intending to hold public hearings in February/March 2011. The Committee is expecting to report to the Legislative Assembly for the ACT as soon as practicable.

# APPENDIX E: 246A Statement to the ACT Legislative Assembly (17 August 2011)

## Statement pursuant to Standing Order 246A relating to the election of a new Deputy Chair of the Standing Committee on Public Accounts

Pursuant to Standing Order 246A, I wish to make a statement on behalf of the Standing Committee on Public Accounts relating to the election of a new Deputy Chair of the Committee.

I wish to inform the Assembly that Mr Brendan Smyth MLA wrote to me as Chair of the Standing Committee on Public Accounts tendering his resignation as Deputy Chair of the Committee. In accordance with the Standing Orders, Mr Smyth's resignation would take effect, when a replacement Deputy Chair had been elected at the next full meeting of the Committee.

I seek leave to table Mr Smyth's resignation letter (dated 5 July 2011) as received by the Public Accounts Committee.

An election for a new Deputy Chair was held on 5 August 2011. Mr John Hargreaves MLA was nominated, accepted the nomination, and was elected unopposed as Deputy Chair of the Committee.

The Committee has resolved for the purposes of progressing its inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010, that notwithstanding Standing Order 226, Mr Brendan Smyth shall chair the Inquiry.

I seek leave to move a motion on this matter.

I move—That the Assembly approves the action taken by the Standing Committee on Public Accounts in relation to the chairing arrangements for the Committee's inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010.

# APPENDIX F: Dissenting report from Ms Caroline Le Couteur MLA

Dissenting Report to

STANDING COMMITTEE ON PUBLIC ACCOUNTS

Inquiry into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010

By

Caroline Le Couteur MLA

DECEMBER 2011

**1. My Involvement in the PAC inquiry**

As stated in the main report, I stood down as committee chair for this report and made a 246A Statement to the ACT Legislative Assembly on 28 October 2010. A copy of the Statement is at Appendix D.

As the statement said, I hold 4.98 per cent of the shares in Australian Ethical Investment and I had been an executive director of Australian Ethical Investment for 17 years. I do not believe, and importantly the Legislative Assembly's Ethics and Integrity Adviser and the rest of the committee did not believe that this involvement constitutes a real conflict of interest for me with respect to this bill.

The Committee also believed that even if the Legislative Assembly was to fully or partly pass the Financial Management (Ethical Investment) Legislation Amendment Bill 2010 then there was no reason to believe that I would benefit financially from that decision. However, to avoid any possible perception of a conflict of interest, I offered to step down as chair for this inquiry and the Deputy Chair kindly agreed to chair the inquiry.

I am clearly on a personal level a supporter of ethical investment, but I wish to make it clear that I do not consider all my investments to be specifically 'ethical'. I have superannuation funds in balanced funds and I am confident that some of these investments would not meet the requirements of the proposed bill. I went into this inquiry with an open mind as to the desirability of ethical investment for the ACT government.

**2. Commentary on the main report**

I disagree with the first recommendation:

*The Committee recommends that the proposed Financial Management (Ethical Investment) Legislation Amendment Bill 2010 not be tabled in the ACT Legislative Assembly, and if tabled, not supported by the ACT Legislative Assembly.*

I think that the proposed bill has merit and that in fact many of the other recommendations of the committee are consistent with the broad direction of the bill. I think that it would have been a much more constructive response for the committee to recommend that the bill be amended to be consistent with its views, rather than rejected.

A large part of the majority of the committee's objections seem to be around the concept of 'ethics'.

The report states "It is not possible to legislate for something to be 'ethical'. Ethics are an individual response to moral issues. Consequently, it is not feasible for any legislation to define an ethical position for a community."(paragraph 2.5).

The Oxford dictionary on line (http://oxforddictionaries.com/definition/ethics) defines ethics as

"Moral principles that govern a person's behaviour or the conducting of an activity"

I would argue that just as ethics govern a person's behaviour they should – and hopefully do – govern the behaviour of organisations and indeed governments.

Some discussions of ethics with respect to public sector activities concentrate only on the ethical dispatch of legal government actions. This is what is considered by Andrew Podger, Public Service Commissioner from 2002 to 2004, when he wrote "In managing ethically, public servants are required to be impartial, to exercise procedural fairness, and to support equity in employment. Having the highest ethical standards presumes more than compliance with the law, including administrative law: it requires a culture or an intuition in decision-making by administrators based on fairness, transparency and accountability and a sense of the public interest, as well as the careful exercise of the legal authorities delegated by Parliament." (http://democratic.audit.anu.edu.au/papers/200512_podger_ps_ethics.pdf). This managerial dimension is I think the only way in which the other members of the committee saw the term 'ethical' used in the context of government or public administration.

However many others take a broader view, that ethics involves, as the dictionary definition says, 'moral principles'. Thus what policies a government should follow are ethical decisions. This is probably easiest to see in debates about how we deal with fellow human beings, do we forbid abortions or euthanasia because as legislators or a community we believe they are unethical?

I would argue that as a community we act on some of our ethical principles via collective government action. We have decided for instance, that it is inappropriate (unethical?), to allow tobacco companies to sell tobacco without restriction. We have made a decision – possible on utilitarian (greatest good for greatest number of people) ethical grounds to restrict sales and consumption, despite the fact it is legal to sell and consume tobacco in many circumstances. Legislation about animal cruelty is another place where it is easy to see that we have legislated for ethical views about the rights of animals – and also easy to see that different parties and individuals have different ethical views.

As I have commented a few times in the main report I think that public policy is the government's or the community's public expression of ethics.

The main report extensively uses the term 'doing well by doing good'. As it says in paragraph 3.29 "The terms commonly associated with its contemporary practice are ethical investment (EI) and socially responsible investment (SRI). The terms are often used interchangeably in the literature and are also used in current practice to refer to a form of alternative investment that considers things other than maximising return when making investment decisions." So I think it is clear that ethical investment is a common term in Australia and quite appropriate for the bill.

However I don't think the real debate with this legislation should be over whether the word 'ethical' is appropriate. If that was the issue, it would be easy to change its name to 'doing well by doing good investment' bill or 'socially responsible investment' bill.

It is not clear to me what the majority of the committee's issue with the bill is.

The subsequent recommendations in my opinion are all trying to move the ACT government's investment practices in the same direction as the bill. Recommendation 2 and 3 are for better reporting on our current investment practices as far as the United Nations Principles of Responsible Investment are concerned. I support these recommendations as it does not appear that as yet we have made any practical changes to our investment polices as a result of our adoption of United Nations Principles of Responsible Investment (UNPRI).

In numerous forums I have asked the government to detail any changes they have made as a result of UNPRI and as yet no one has mentioned a change. In the latest annual report hearings (http://www.hansard.act.gov.au/hansard/2009/comms/public49.pdf) I asked "So basically there is nothing we have divested because of the ESG issues?". The conversation continued -
**"Mr McAuliffe**: No, there is not.
**Mr Broughton**: No, that statement is not quite correct.
**THE CHAIR**: Okay. So what have we disinvested in because of ESG issues?
**Mr Broughton**: We may have, but we are not able to distinguish whether an investment consultant on our behalf has divested of something solely because of ESG issues or because of a combination of ESG and possible future investment expectations.
**THE CHAIR**: You think it is possible that this could have happened? Maybe you need to take this as a question on notice."

The Public Accounts Committee has not, as yet, received any information detailing any investment divestments.

The issue of voting – which is also part of UNPRI was discussed extensively in the hearings with Treasury as part of this inquiry.

**"Mr McAuliffe**: No, we have delegated the voting decisions to our managers to exercise—
**MS LE COUTEUR**: Have you given them any guidance on this?
**Mr McAuliffe**: The way fund managers typically vote is that they are managing a pool of investments for a range of clients and, if they are given a delegation on how to vote, they form a voting position on the voting issue.
**MS LE COUTEUR**: So—
**Mr McAuliffe**: And they exercise that vote for all of the votes that they represent. They do not think, "Hang on, with 98 per cent of our votes we're going to support the motion and vote two per cent against the other way for a particular client. That is not the way the process works. If clients choose to have the opportunity to override that voting position, that would require the individual client to go through and do all the internal research and process to form a voting decision and then instruct the manager to override their vote—or, alternatively, do the direct voting themselves."

(http://www.hansard.act.gov.au/hansard/2009/comms/public41.pdf)

Recommendation 4 is a particularly useful recommendation:

*The Committee recommends that the ACT Government, as an institutional investor should actively pursue a policy of responsible investment with selective use of exclusion-based or negative screening strategies in the context of public policy.*

The proposed bill also suggested negative screening so again it is unclear why the majority of the committee wishes to vote against a bill which they support part of, rather than suggest amendments.

The area that the main report leaves unclear is how to choose what the ACT government should exclude. The bill had clear rules which would be voted on by the Assembly. One submitter (Mr Scott Donald, *Transcript of evidence*, 2 August 2011, p. 83) suggested that the bill should change the rules to be a disallowable instrument to allow for easier changes to the activities excluded and I think that idea has merit. It would still require Assembly consent to any exclusions.

The majority of the committee argued against the bill saying in paragraph 2.6 "the objectives underlying the Bill could be 'captured' by a specific interest group to further its own political objectives. As this Bill has been drafted by the Greens, it is reasonable to hypothesise that the passing of this Bill in its current form will simply provide that political party with a platform to pursue its own political ideology."

I assume this comment refers to the activities to be excluded. It ignores the fact that the bill to become law would have to be passed by the Assembly and thus the 'political objectives' 'captured' could only be ones agreed to by the Assembly as a whole.

However in proposing their methodology it seems the majority of the committee does not want any Assembly involvement or scrutiny of what the ACT government should exclude.

In paragraph 5.35, the committee writes "The Committee is of the view that the ACT Government, as an institutional responsible investor, should ensure that its nominated investment criteria are representative of the community it serves." I agree with this sentence and that is what the Green bill aimed to achieve. The second sentence in the paragraph says "As discussed earlier in this report, norms-based investment criteria are the most appropriate means by which governments, as institutional investors, can do this as they are founded on universally agreed and accepted principles." I do not agree as the main report has not provided any clarity as to what the 'universally agreed and accepted principles' are. If there are 'universally agreed and accepted principles' why has the report not listed them?

In paragraph 4.11 the committee says "Norms-based investment criteria or principled-based investment criteria are essential for any form of EI or SRI investment by governments. The basis for this is two-fold: (I) firstly, it acts as a safeguard against EI and SRI practices becoming captured politically, for example, by not permitting a group of people to become sole arbiters of what should or should not be invested in." I would argue that by submitting the activities to be excluded to the Assembly the proposed bill gives an opportunity for wide community involvement in the criteria. Instead the main report seems to be proposing a method that is behind closed government doors and thus much more likely to be 'captured politically'.

The committee is recommending exclusions that are 'norms based' rather than 'ethically based'. I am not sure what the majority of the committee is trying to achieve here. Paragraph 4.11 continues to says that Norms-based criteria "rest on universally agreed and accepted principles, in the form of international standards, treaties and conventions". My response to this is which international standards, treaties and conventions do you chose to use? Why is the committee only interested in international standards etc – or is that just a poorly written paragraph? Why does the committee not want the ACT government to make that choice? I would have thought that the choice should be based on the ACT government's public policy directions and that is what the proposed bill is aiming to do. The committee inquiry and then the bill's debate in the assembly should provide a forum for debate about what norms we should attempt to implement as part of our investments.

I'm not sure if in proposing 'norms' the majority of the committee is in fact trying to say that we should be doing 'best of sector' investing. In that the investor does not make any judgement about the worth of the type of activity or sector that the investment is in. They seek only to invest in the best of the sector – based on 'best practice'. There are some 'socially responsible' investment funds that follow that practice.

I find the preference for nebulous 'norms' to be determined by the government without any necessary Assembly or community involvement, rather than clear criteria determined by the Assembly to be strange and illogical. I fear that the reason for the alternative formulation of exclusion criteria is to ensure that in fact no criteria are developed and no areas of activity are excluded.

Recommendation 5 to call the government's investment framework 'responsible investment 'is not really needed but I support it. I also support Recommendation 6 for the ACT government to develop a policy of responsible investment.

Recommendation 7 is the key recommendation putting forward the committee's views on the way forward and I support it as an improvement on where we are now.

It says:

*The Committee recommends that the implementation and reporting requirements for the proposed responsible investment policy be detailed in the policy. Amongst other things, the policy should:*

1. *set out norms-based investment criteria for the Territory's investments that are consistent with internationally recognised norms and conventions relevant to responsible investment and the ACT Government's status as a signatory to the United Nations' Principles of Responsible Investment*
2. *in the main, use engagement and integration investment strategies supplemented by the selective use of exclusion-based screening strategies consistent with the ACT Government's articulated public policy context*
3. *require the ACT Government to instruct its fund managers to invest according to the specified norms-based investment criteria*
4. *specify an annual reporting and disclosure requirement to ensure transparency with regard to the Territory's investments. Reporting and disclosure requirements should use an "if not, why not?" test,*
5. *require that funds are not invested in ways that are inconsistent with the core investment objectives of the Territory, and*
6. *require the ACT Government to comply with the policy and report annually on it to the ACT Legislative Assembly.*

With respect to point 1, as noted before it is not clear what these 'norms and conventions relevant to responsible investment' are and who will determine them. Will the ACT government being doing a poll of responsible investment managers to determine what they think our policy should be?

Point 2 I do not think 'selective use' should be code for no use. Given the position of the ACT government I do agree that use of engagement – and in particular public engagement – is very important.

I support point 3– I assume that it means both positive and negative screening.

Point 4 is a positive step to better reporting and I support it. I'm not quite sure what is meant by the 'if not, why not?' test in this context.

I support Point 5 which should be a matter of course.

Point 6 is a positive step to better reporting and I support it.

I support recommendation 8 to provide an annual list of its shareholdings. This will give useful information to see if the responsible investment policy is making a difference.

Recommendation 9 that "the ACT government... sponsor or co-sponsor public engagements and shareholder resolutions on matters of concern" is a useful recommendation. I hope the government will make good and active use of it. Given the ACT's clear commitment to greenhouse gas emission reduction, international treaties in this area, and the involvement of many of the companies that the ACT government invests in, in greenhouse gas production, I think that this should be an area of immediate implementation of this recommendation.

**Comments on proposed bill**

Ethical investment was first raised in the Assembly in 1996 by Ms Tucker during the debate on the Financial Management Act. In 2002 the then Treasurer Mr Quinlan indicated that indeed the government consider ethics in investment decisions in the context of risk and return. When part of the ACT government's investment portfolio was listed in the Canberra Times there was considerable public disquiet. This lead to the ACT signing up to the United Nations Principles of Responsible Investment (UNPRI).

As discussed in the main report and my comments in fact it is fair to say that nothing has actually changed as a result of our commitment to UNPRI so far. So far the government has taken the symbolic step only. The proposed bill is a direction to go further and translate words into action.

The exclusions proposed in the bill were based on government policy. For example, the government attempts to reduce smoking but its investments meant that we profit from more people smoking. We have legislated for a 40% decrease in greenhouse gas emissions but our investments mean we profit from the sale of coal fired electricity generation. We have legislated to implement human rights but we are investing in the production of cluster bombs that we know will kill innocent human beings.

I hoped that the exclusion list would be the subject of much community debate – facilitated by the inquiry into it.

As well as being based on government policy the proposed negative screens were informed by practices in the ethical and (socially) responsible industry. I am therefore hopeful that when a 'norms' based responsible investment policy is created then it will include some of the same exclusions.

The bill also proposed some positive support for socially responsible investment – where financially prudent. There has not really been any negative commentary about this as part of the inquiry so I am hopeful that recommendation 7(c) encompassed this.

As acknowledged in the main report, there is no evidence that choosing to exclude a small range of activities from the ACT government's investments will reduce the government's financial returns.

**Conclusion**

While I disagree with the first recommendation of the report, I agree with the other recommendations. These recommendations are consistent with the direction of the bill and I think it is disappointing that the report did not recommend changes to the bill rather than scrapping it.

I am concerned about the lack of transparency in the proposed 'norms' based responsible investment policy. I am concerned that it may in fact lead to another policy that has no on the ground action.

I think that the discussion about increased advocacy by the ACT government as a shareholder is very positive. This is clearly something that can be done without affecting investment returns or risk. I hope that a lead by the ACT government will lead to other governments and institutional investors also advocating for better practices in investee companies.