

## **EXPLANATORY STATEMENT**

### **Objective of the Directions**

As stated in the *Medical Research Future Fund Act 2015* (the Act), the Government has established the Medical Research Future Fund (the Fund) to provide grants of financial assistance to support medical research and medical innovation.

The Government's aim is to accumulate \$20 billion in financial assets in the Fund by the year 2020 and to reach disbursements of around \$1 billion per year from approximately 2023/24. In achieving this aim the Government has the expectation that the Future Fund Board of Guardians (Board) will take a long-term outlook when setting the investment strategy for the Fund.

The Government will make contributions to the Fund of the uncommitted funds in the Health and Hospitals Fund (HHF), and the estimated value of relevant health savings from the Health portfolio until the Fund reaches a target capital level of \$20 billion.

Under the Act the Board, in investing the Fund, must seek to maximise returns on the Fund over the long-term and to enhance the Commonwealth's ability to provide grants for medical research and innovation. This investment function is subject to any restrictions placed on the Fund by the Act and to any directions given by the responsible Ministers under subsection 39(1). Directions issued under subsection 39(1) of the Act are known collectively as the Medical Research Future Fund Investment Mandate.

### **Directions**

In setting this investment mandate the Government has employed the principle that any restriction placed on the investment of the Fund will lead to some increased risk or lower return or some less favourable trade-off between the two. As such, restrictions are only imposed where there is a sound public policy or national interest reason to do so.

#### *Benchmark return*

For the purpose of this investment mandate, the Government has directed the Board to adopt an average return of at least the Reserve Bank of Australia Cash Rate target + 1.5 to 2 per cent per annum, net of investment fees, over a rolling 10 year term as the benchmark return on the Fund.

The Government is conscious of the risks inherent in investing a large portfolio of financial assets and acknowledges that in practice this will involve some short-term volatility in the Fund's returns, including the possibility of losses in some years. In targeting the long-term benchmark, the Board is directed to determine an acceptable but not excessive level of risk for the Fund. This level of risk should be measured in terms such as the probability of losses in a particular year. The level of risk should also take into account the principle as specified in subsection 34(4)(a), to preserve the nominal value of any amounts that are credited to the Fund under subsection 12(1) or section 15 of the Act over the long-term. Furthermore, the Board must also take into account the principle as specified in subsection 34(4)(b), that the volatility of maximum annual distributions be moderated from financial year to financial year (to the extent possible).

Consistent with the requirements of the Act, in issuing these directions, the Government is committed to:

- maximising the return to the Australian public by investing for the long-term; and
- enhancing the Commonwealth's ability to provide grants for medical research and innovation.

Therefore the investment mandate establishes long-term performance measures. The Government's intention is that these directions may be reviewed in 2020 and that new directions may be issued in light of material changes in the investment environment faced by the Fund or in the national interest.

Section 56 of the Act requires the Board to keep the Ministers informed of the operations of the Board and give the nominated Minister such information in relation to those operations as is appropriate. This could include information the Board considers to be relevant on any significant changing circumstances of the Fund or broader financial markets.

#### *Board must consider impacts from its investment strategy*

The Government has a broad obligation to the Australian community to make decisions that are economically and fiscally responsible. In establishing the Fund it is the expectation of the Government that the investments of the Fund should not disrupt the normal operation of domestic financial markets. The Board, in setting the investment strategy and in instructing the investment of the Fund, must act in a manner that minimises the potential to effect any abnormal change in the volatility or efficient operation of Australian financial markets.

The Board is also required to act in a manner that is unlikely to cause any diminution of the Government's reputation in Australian and international financial markets.

The Government participates in a number of international organisations which pursue high standards of conduct in financial markets. The Government recognises that the Board will invest in international capital markets as part of a sound investment strategy involving diversification. In doing so, the Government expects that the Board will act in a manner that is unlikely to cause embarrassment to the Government.

#### *Corporate governance*

In undertaking its investment functions, the Board must act consistent with, and establish policies on matters relevant to, international best practice for institutional investment. In particular, the Government would expect the Board's policies to include its approach to corporate governance principles, including its voting policy.

**Consultation**

The Future Fund Board of Guardians was consulted on the investment mandate in accordance with section 42 of the Act.

The Office of Best Practice Regulation assessed that the impact of the changes made by the investment mandate are minor and do not require a Regulation Impact Statement (OBPR ID: 19917).