

EXPLANATORY STATEMENT

Objective of the Directions

As stated in the *Future Fund Act 2006* (the Act), the Government has established the Future Fund (the Fund) to strengthen the Australian Government's long-term financial position by making provision for unfunded superannuation liabilities that will become payable during a period when an ageing population is likely to place significant pressure on the Government's finances.

Under the Act the Board is responsible for seeking to maximise returns on the Fund over the long-term. This responsibility is subject to any restrictions placed on the Fund by the Act and to any directions given by the responsible Ministers under subsection 18(1) or clause 8 of Schedule 1 of the Act. Directions issued under subsection 18(1) of the Act are known collectively as the 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, as the long-term benchmark for the performance of the Fund, an average return over the long-term of at least the Consumer Price Index (CPI) + 4 per cent to + 5 per cent per annum.

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.

Section 55 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.

Limits for holding of listed companies

The Act sets out a number of legislative restrictions in relation to the investment of the Fund. Sections 21 and 22 of the Act prohibit the Board from triggering the takeover provisions under the *Corporations Act 2001* and restrict the Board from holding a stake of more than 20 per cent in any foreign publicly listed company.

To provide the Government with comfort that these legal restrictions will be met, the investment mandate directs that the Board must establish a practical working limit to prevent a breach.

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 voting its shares.