

2004-2005

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

FUTURE FUND BILL 2005

EXPLANATORY MEMORANDUM

(Circulated by the authority of the Minister for Finance and Administration,
Senator the Hon Nick Minchin)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
ABS	Australian Bureau of Statistics
Act	Future Fund Bill as passed
Acts Interpretation Act	<i>Acts Interpretation Act 1901</i>
Agency	Future Fund Management Agency
Bill	<i>Future Fund Bill 2005</i>
Board	Future Fund Board of Guardians
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
Corporations Act	<i>Corporations Act 2001</i>
Financial Sector (Shareholdings) Act	<i>Financial Sector (Shareholdings) Act 1998</i>
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMA Regulations	Financial Management and Accountability Regulations 1997
Fund	Future Fund
ITAA 97	<i>Income Tax Assessment Act 1997</i>
LIA	<i>Legislative Instruments Act 2003</i>
Public Service Act	<i>Public Service Act 1999</i>
responsible Ministers	The Treasurer and the Finance Minister
Uhrig Review	Review of the Corporate Governance of Statutory Authorities and Office Holders, June 2003

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Outline and Financial Impact Statement

Outline

2.1 The Future Fund Bill 2005 ('the Bill') gives effect to the Government's commitment (made during the 2004 federal election) to establish a dedicated financial asset fund — the Future Fund ('the Fund') — to meet unfunded superannuation liabilities. By accumulating assets to meet liabilities that will become payable at a time when spending pressures associated with an ageing population are likely to hit, the Fund will strengthen the Government's balance sheet and help ensure the long-term sustainability of its finances.

2.2 The Bill establishes the following:

- The Fund, which is a financial asset fund consisting of cash and investments of the Fund;
 - The Bill grants the Treasurer and the Finance Minister ('the responsible Ministers') the power to credit cash amounts to the Fund through a Special Account (also established by the Bill) and to transfer financial assets to the Fund.
 - The Government's policy is to source transfers to the Fund from realised cash surpluses, including seed capital of \$18 billion from previous realised surpluses, and the proceeds of any future asset sales. The Government may also transfer some of its remaining equity in Telstra to the Fund.
 - The Bill quarantines all Fund assets for the purpose of making provision for the Government's unfunded superannuation liabilities. Consistent with this principle, the Bill provides for all earnings of the Fund to be reinvested.

- The Future Fund Board of Guardians ('the Board') as a body corporate to provide a separate legal identity from the Government with statutory responsibility for managing the investments of the Fund; and
 - The Board consists of a Chair and six other members, all appointed on a part-time basis. The responsible Ministers will be responsible for the appointment and removal of Board members in accordance with the criteria set out in the Bill. The Board's remuneration will be set by the Remuneration Tribunal.
 - The Board will hold Fund investments in its own name on behalf of the Commonwealth – illustrating that the Board will take investment decisions independent of the Commonwealth but with the Commonwealth retaining beneficial ownership of the Fund at all times.
- The Future Fund Management Agency ('the Agency'), which will be a statutory agency for the purposes of the *Public Service Act 1999* ('the Public Service Act') and will be prescribed for the purposes of the *Financial Management and Accountability Act 1997* ('the FMA Act') prior to the commencement of the relevant section of this Bill. The Chair of the Board will be the Agency Head for the purposes of the Public Service Act and the Chief Executive of the Agency for FMA Act purposes.
 - The Agency will provide executive support for the Board and will be responsible for the operational activities associated with the investment of the Fund. In practice, while the Board will decide how the Fund is to be invested, the Agency will be the entity that ensures monies are allocated consistent with those decisions.

2.3 The Board has the power to invest the Fund in a broad range of financial assets, including overseas financial assets. The intention of the Board's investment powers is to ensure that the Fund can be invested in a wide range of financial assets to maximise the benefits of diversification.

2.4 While the Board will not be able to invest the Fund directly in non-financial assets, which includes direct investment in property or infrastructure, it will be able to make investments through pooled property and investment vehicles including trusts, private companies or listed companies that invest in property or infrastructure.

- Given the size of the Fund, the restriction on direct investment in non-financial assets is unlikely to have practical consequences for the Board's ability to obtain appropriate returns on the Fund.

2.5 The Bill requires responsible Ministers to issue an investment mandate — a collection of Ministerial directions — to the Board regarding the investment of the Fund.

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- The purpose of the investment mandate is to provide a mechanism for the Government to provide strategic guidance to the Board on its expectations for the investment of the Fund.
- The investment mandate may include, but need not be limited to, directions on the Government's expectations for returns on the Fund, its tolerance for risk and any restrictions on the investment of the Fund.
- Any directions must be tabled in Parliament but will not be disallowable, consistent with most Ministerial directions issued to statutory bodies.

2.6 The Bill requires that the responsible Ministers must invite the Board to make a submission on any draft directions and to table any submission of the Board in Parliament with the final investment mandate. This ensures the Board has an avenue to make public its views on the impact of any directions on its investment activities.

2.7 The responsible Ministers may issue a new investment mandate at any time, subject to the requirement that it consult the Board. However, the intention is that the investment mandate will reflect the long-term nature of the Government's Future Fund policy and will only be updated where there is a policy imperative or significant change in the investment environment faced by the Fund.

2.8 The Fund may be drawn upon to meet unfunded superannuation liabilities from the earlier of the point at which Fund assets are sufficient to offset those liabilities or 1 July 2020, when the budget is expected to face pressures due to the ageing of the population.

- The advice of an independent actuary will inform the responsible Ministers on whether the liability has been fully offset.
- Draw downs over a financial year will be capped at the level of unfunded superannuation liabilities (benefit payments) paid out.

Financial impact

2.9 The Government's policy is to make contributions to the Fund after it has met all other spending commitments. That is, the Fund 'stands in line' behind the Government's other expenditure priorities.

2.10 Transfers to the Fund will not impact on the budget bottom line since the Government is merely exchanging one form of financial assets (cash and possibly Telstra shares) for another (such as domestic and overseas equities).

2.11 The forward estimates reflect that the Government has not committed to making contributions to the Fund beyond the seed capital. In the 2005-06 Budget, the Government committed to providing the Fund with \$16 billion in seed capital out of accumulated surpluses, with the final amount to be determined once the 2004-05 surplus was realised. Based on the 2004-05 Final Budget Outcome, the Government has decided to transfer seed capital to the Fund of \$18 billion before the end of 2005-06.

2.12 Fund earnings are recorded on the Government's balance sheet but are excluded from the underlying cash balance ('the UCB') as they are not available to meet current payments.

- Including Fund earnings in the UCB would effectively overstate the amount available to the Government for current period payments since earnings have been pre-committed to meeting unfunded superannuation liabilities that will become payable in the future.

2.13 Draw downs from the Fund from (or before) 2020 will, in isolation, improve the budget by freeing up resources that would otherwise need to be committed to meeting unfunded superannuation liabilities.

2.14 Under the Bill, the Board is eligible to receive a refund of imputation credits. Due to the treatment of Fund earnings, the refund of imputation credits will reduce the UCB by the amount of the refund each year. Although the refund involves a reduction in the UCB, it is effectively only a transfer of resources from one part of the General Government Sector to another. Therefore, there is no impact on the fiscal balance or the headline cash balance.

2.15 All expenses associated with the investment and administration of the Fund by the Board, including funds manager's fees, will be met from the Fund.

2.16 The 2005-06 Budget announced that the running costs of the Agency would be met out of the budget each year. The Government has now decided the running costs of the Agency will be met from the Fund. This is only a change in the source of the Agency's funding — the Agency's expenditure will still be subject to Parliamentary scrutiny through the budget and estimates hearings process.

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Part 1 — Introduction

Short title

3.1 This Act may be cited as the Future Fund Act 2005. [*Part 1, section 1*]

Commencement

3.2 The short title and commencement provisions of the Act start on the day on which the Bill receives Royal Assent. [*Part 1, subsection 2(1)*]

3.3 All other sections and schedules commence on the date fixed by a proclamation issued by the Governor-General, providing this is within six months of Royal Assent of the Bill. This allows time following the approval of the Bill by Parliament to ensure the Board and Agency are in a position to be able to independently carry out their respective duties before the Act effectively commences. [*Part 1, subsection 2(1)*]

- Section 4 of the *Acts Interpretation Act 1901* ('the Acts Interpretation Act') allows the responsible Ministers to appoint Board members prior to the commencement of the Act. However, any appointments made only commence with the relevant sections of the Act.

3.4 If the schedules and sections other than the short title and commencement provisions have not commenced on a day within six months of the date of Royal Assent of the Bill, they commence on the day after the end of that six month period regardless of any proclamation that has been made. [*Part 1, subsection 2(1)*]

Object

3.5 As defined in section 3, the object of the Act is to establish the Future Fund in order to strengthen the Commonwealth's long-term financial position.

The Fund achieves this objective by making provision for unfunded superannuation liabilities that will become payable during a period when an ageing population is expected to place significant pressure on the Commonwealth's finances. The 2002 Intergenerational Report indicates that this period is expected to commence in 2020. *[Part 1, section 3]*

Simplified outline

3.6 The simplified outline is intended to provide a high level introduction to the contents of this Act in order to aid readability. *[Part 1, section 4]*

Definitions

3.7 Section 5 defines the key terms used in this Act. Although these are largely self-explanatory, the following points should be noted:

- The term 'body' in the definition of 'investment manager' is intended to be read broadly to include limited liability corporations, sole corporations and other entities.
- The funded component takes on the generally accepted actuarial meaning of funded.
- It is intended that any restrictions that would stop a product from having a market value (such as trading restrictions) are disregarded for the purposes of determining the value of an asset.

Financial assets

3.8 The definition of financial asset is intended to be widely read, consistent with the definition of financial asset used for budget reporting purposes. This definition is derived from the Australian Bureau of Statistics ('the ABS') manual of concepts and classification principles used for publishing government finance statistics. The ABS publication is based on a similar manual produced by the International Monetary Fund. *[Part 1, section 6]*

3.9 Consistent with the Future Fund being a financial asset fund, the Board can only invest the Fund in financial assets. Allowing the Board to invest directly in non-financial assets would be inconsistent with the objectives of the policy and the Government's broader fiscal policy and budget management.

- This restriction extends to investing directly in infrastructure, property, jewellery or artwork, for example. However, the Board will be able to gain exposure to these types of assets through pooled property or other investment vehicles (listed and unlisted).

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3.10 Regulations may also be made to clarify that an asset specified in the regulations is a financial asset for the purposes of this Act. It is not intended that these regulations would contradict the definition of a financial asset in the ABS publication — merely that it would provide the Board with certainty in relation to whether certain assets would fit within this definition. For the same reason, the regulations may also clarify that an asset is not a financial asset. *[Part 1, section 6]*

Crown to be bound

3.11 The Crown is bound in all its capacities by this Act. *[Part 1, section 7]*

Extension to external territories

3.12 The Act applies to all external territories of Australia, including Norfolk Island. *[Part 1, section 8]*

Extra-territorial application

3.13 The geographical reach of this Act is very wide – applying both within and outside of Australia — because it is expected the Fund will be invested in overseas markets. This section overrides subsection 21(1)(b) of the Acts Interpretation Act by extending its application outside Australia. *[Part 1, section 9]*

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Part 2 — The Future Fund

Simplified Outline

4.1 The simplified outline is intended to provide a high level introduction to the contents of this Part of the Act in order to aid readability. *[Part 2, section 10]*

Establishment of the Fund

4.2 Section 11 establishes a financial asset fund — the Future Fund — consisting of amounts credited to a Special Account (see below) and investments of the Fund. The distinction between the cash and asset components of the Fund relates to the need for cash to be duly appropriated rather than a desire to distinguish between cash held and other types of investments. *[Part 2, section 11]*

4.3 ‘Investments of the Fund’ is defined in section 16 to include monies invested in financial assets (including returns on these investments), derivatives acquired under section 25 and other financial assets that the Board becomes a holder of through a securities lending arrangement or otherwise.

Establishment of the Future Fund Special Account

4.4 Section 12 establishes the Future Fund Special Account (‘the Fund Account’) — a Special Account for the purposes of section 21 of the FMA Act. A Special Account is a ledger which records a right to draw money from the Consolidated Revenue Fund.

- Any amounts credited to the Fund Account are quarantined from the rest of the Consolidated Revenue Fund and can only be debited for the purposes set out in clause 2 of Schedule 2.

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4.5 Note 2 clarifies that in addition to the determinations process set out in clauses 2 and 3 of Schedule 1, amounts can be credited to the Fund Account by an appropriation bill. *[Part 2, section 12, note 2]*

Operation of the Future Fund

4.6 Section 13 clarifies that the Schedules to the Act apply. These cover credits of amounts to the Fund, transfers of assets to the Fund, debits of amounts from the Fund and target asset level declarations. *[Part 2, section 13]*

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Part 3 — Investment of the Future Fund

Simplified outline

5.1 The simplified outline is intended to provide a high level introduction to the contents of this Part of the Act in order to aid readability. [*Part 3, section 14*]

Objects of investment of the Fund

5.2 Section 15 is intended to reinforce that amounts invested are invested for the purpose of enabling the Commonwealth to meet unfunded superannuation liabilities and the associated costs or expenses of managing the Fund referred to in clause 2 of Schedule 2.

Investment of the Fund and management of the investments of the Fund

5.3 The purpose of this Part is to allow the Board to invest the Fund with much the same investment capabilities as a superannuation fund or other large institutional investor, except where there are policy reasons to impose restrictions.

5.4 Sections 16 and 17 are modelled on the investment powers under section 39 of the FMA Act. However, subsection 16(1) expands those powers to specifically provide for the investment of the Fund in a broad range of financial assets.

- This approach is similar to section 7A of the *Reserve Bank Act 1959* which excludes the application of section 18 of the *Commonwealth Authorities and Companies Act 1997* (‘the CAC Act’), thereby providing broader investment powers.

5.5 The Fund is able to be invested in a broad range of financial assets [*Part 3, section 16*]. Conditions on the acquisition of derivatives are covered later

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in the Act. Investments are to be made in the name of the Board rather than the Commonwealth to reinforce that the Board manages the Fund at arms length from the Government; however, beneficial ownership of the Fund remains with the Commonwealth at all times [*Part 3, subsection 16(2) and Part 4, section 36*].

5.6 Monies invested in financial assets, and any derivatives acquired under section 25, are ‘investments of the Fund’ and these investments may be realised, disposed of or redeemed by the Board. [*Part 3, subsections 16(3), 17(2) and 17(3)*]

5.7 To give effect to the requirements under sections 81 and 83 of the Constitution (which in effect provide that public money forms part of the Consolidated Revenue Fund and can only be spent if authorised by an appropriation made by law), income derived from an investment of the Fund, including a return of capital or another form of financial distribution, must be credited to the Fund Account [*Part 3, subsection 17(4)*]. In practice, any money that has not been invested must be held in an official bank account. (The requirement to hold the money in an official bank account is covered by the FMA Act.)

5.8 The Board is able to authorise, prior to an investment maturing, that the proceeds of this investment be automatically reinvested with the same entity rather than needing to be treated as public money and credited to the Consolidated Revenue Fund only to be then reappropriated and reinvested — it is neither sensible nor practicable to attempt to account for these proceeds as receipts of public money. Any reinvestment is an investment of the Fund. This section is consistent with subsection 39(6) of the FMA Act. [*Part 3, subsection 17(5)*]

Investment Mandate

5.9 It is appropriate that the Government, as manager of the economy and owner of the Fund, have a mechanism for articulating its broad expectations for how the Fund will be invested and managed by the Board. Section 18 establishes a framework that enables the Government to give strategic guidance to the Board while preserving the Board’s role in managing the investment of the Fund at arms length from Government.

5.10 Under subsection 18(1), the responsible Ministers have the power to give the Board written directions in relation to the performance of its investment functions and the exercise of its powers.

5.11 The responsible Ministers must issue at least one direction under this section, to ensure that an investment mandate is in force at all times. This is done to provide clarity for the Board. [*Part 3, subsection 18(1)*]

5.12 The fact that a direction has already been issued does not prohibit the responsible Ministers from issuing additional directions. All of these directions together comprise the investment mandate. *[Part 3, subsections 18(1) and 18(3)]*

- While the responsible Minister can issue new directions at any time, the intention is that the investment mandate will reflect the long-term nature of the Government's Future Fund policy and that new directions will only be issued in light of significant policy changes, material changes in the investment environment faced by the Fund, or in the national interest.

5.13 In setting an investment mandate, the responsible Ministers are to have regard to maximising the return on the Fund over the long term consistent with international best practice for institutional investment and any other matters the Ministers consider to be relevant. This requirement will give the Board, and the Parliament, comfort that the responsible Ministers must consider the scope of their directions from an investment perspective while ensuring that the responsible Ministers still have the flexibility to consider broader policy and national interest considerations. *[Part 3, subsection 18(2)]*

5.14 Subsections 18(4) and 18(5) provide that the investment mandate may include, but is not limited to, statements about policies the Board must pursue in relation to risk and return and the allocation of the Fund to particular asset classes.

- This may include restrictions or thresholds for investing the Fund in certain jurisdictions or asset classes and statements of the Government's tolerance for losses.

5.15 Subsection 18(4) ensures that the Board is not given conflicting directions regarding the Government's tolerance for risk, its expectations for returns and any associated allocation of the Fund across asset classes.

5.16 To avoid doubt, subsection 18(7) makes it clear that the scope of the responsible Ministers' power to issue directions to the Board in relation to the investment of the Fund is bounded by the Act. For example, the responsible Ministers could not direct the Board to use derivatives in a manner that contradicted section 25.

5.17 To allow the Board time to adjust to any revised directions issued by the responsible Ministers, the investment mandate does not formally commence until 15 calendar days after it is issued. Importantly, the Board will be able to adjust with certainty that the new direction will come into force. *[Part 3, subsection 18(8)]*

5.18 Directions under subsection 18(1), that set out certain rules that the Board must comply with, are legislative in character and are therefore

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legislative instruments for the purposes of the *Legislative Instruments Act 2003* ('the LIA'). However, any directions issued by the responsible Ministers as part of the investment mandate are exempt from Parliamentary disallowance (covered by section 42 of the LIA) under item 41 of the table in subsection 44(2) of the LIA. [*Part 3, subsection 18(9)*]

- As legislative instruments, any directions given to the Board under this section of the Act are required to be registered on the Federal Register of Legislative Instruments and tabled in Parliament.
- This approach enables the public and Parliament to hold the Government accountable for the directions it issues to the Board without impeding the Government's ability to manage its finances.

5.19 Subsections 18(10) and 18(11) provide that, subject to the restrictions set out in the Act and the expectations of the Government as articulated in the investment mandate, the Board has a statutory obligation to seek to maximise Fund returns over the long term, consistent with international best practice for institutional investment.

- This provision (together with 18(6)) establishes a clear hierarchy of priorities for the Board — the responsibility to maximise returns is subordinate to the investment parameters set out by the Parliament and Government. This framework provides appropriate flexibility while still ensuring suitable accountability for any directions the Government gives the Board regarding the investment of the Fund.
- It also provides the Board with clarity as to the extent of its accountability — the Board must be able to demonstrate that it is pursuing policies and strategies that are clearly directed at maximising long-term investment returns in a manner that is consistent with best practice.
- In practice, it is expected that the Board will adopt a best practice approach to a range of issues by learning from the experiences of other investors and funds of national significance.

5.20 The responsible Ministers are required to review the investment mandate in consultation with the Board before amounts start to be drawn down from the Fund for the purposes of paying unfunded superannuation liabilities [*Part 3, subsection 18(12)*]. This ensures that there will be a formal process of dialogue between the Government and the Board on the potential impact of such payments on the investment of the Fund. Note that this provision does not require the responsible Ministers to change the investment mandate in force at that time.

Board to be consulted on Investment Mandate

5.21 The responsible Ministers are required to consult the Board on any changes or additions to the investment mandate. This is achieved by the responsible Ministers sending a draft of the new direction to the Board and inviting the Board to make a submission within a reasonable time limit. *[Part 3, subsections 19(1) and 19(3)]*

- What constitutes a reasonable time limit will be determined on a case-by-case basis with regard to relevant circumstances and priorities at the time.
- It may be the case that urgent changes are required in the national interest. In this situation, it would be reasonable for the Board to be asked to consider the draft direction quickly.
- However, where there is less urgency, or the change in the investment mandate is quite substantial, it would be reasonable to provide the Board with more time to consider the draft direction.

5.22 Any submission received by the responsible Ministers from the Board must be tabled in Parliament with the new direction *[Part 3, subsection 19(2)]*. In this way the Board will be able to ensure that their views on the expected impact on their ability to maximise returns are publicly known.

Compliance with Investment Mandate

5.23 It is the responsibility of the Board to take all reasonable steps to ensure that all policies and decisions regarding the operation and investment of the Fund are in accordance with any directions (investment mandate) issued by the responsible Ministers. *[Part 3, subsection 20(1)]*

5.24 Since the investment mandate is intended to provide broad guidance to the Board it may contain directions that require the Board to apply its judgement on whether or not the Fund is complying with the mandate.

5.25 If the Board becomes aware of a breach of the investment mandate or judges that a policy does not comply with the investment mandate it must inform the responsible Ministers in writing as soon as is practical, including a proposed strategy to bring the operations of the Fund into accord with the investment mandate. *[Part 3, subsection 20(2)]*

5.26 Similarly, if the Government identifies areas where the Board is not complying with the investment mandate, the responsible Ministers can issue written directions to the Board to take action to remedy the situation. The Act

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requires the Board to comply with any such directions, underlining that the responsible Ministers are the final arbiters on what is intended by the investment mandate. *[Part 3, subsections 20(3) and 20(4)]*

5.27 Any transactions undertaken by the Board that are deemed later not to have complied with the investment mandate are still valid and the Board is required to honour any commitment made. This protects third parties who enter into transactions with the Board or its agents in good faith. *[Part 3, subsection 20(5)]*

5.28 A direction under subsection 20(3) is administrative in character and therefore not a legislative instrument for the purposes of the LIA. *[Part 3, subsection 20(6)]*

Board must not trigger the takeover provisions of the Corporations Act 2001 or have a significant stake in a foreign listed company

5.29 To minimise market distortion and eliminate the potential for conflicts of interest for the Government as a market regulator, the Board is prohibited from triggering the takeover provisions under section 606 of the *Corporations Act 2001* ('the Corporations Act') or acquiring more than a 20 per cent stake (as defined in the *Financial Sector (Shareholdings) Act 1998* ('the Financial Sector (Shareholdings) Act') with a few minor adjustments) in a foreign publicly listed company. *[Section 606 of the Corporations Act and Part 3, subsection 22(1)]*

5.30 It is the Government's intention that the takeover threshold be adhered to quite strictly for unlisted companies with more than 50 shareholders and listed companies. Therefore, the exceptions provided under section 611 of the Corporations Act do not apply for acquisitions by the Board *[Part 3, subsection 21(2)]*. However, the restrictions are not expected to have a material impact on the investment efficiency of the Fund as they are quite similar to the limits that other fund managers often use.

5.31 The above restrictions only apply to publicly listed companies and unlisted companies with more than 50 shareholders. Applying these restrictions more broadly would prevent the Board from gaining meaningful exposure to particular asset classes, such as private equity and infrastructure (through unlisted investment vehicles). In addition, the Board holding a significant interest in a relatively small unlisted company poses less potential for conflict for the Government through its market regulatory role than exists in relation to a relatively large listed company.

5.32 Any holding that arises through a transfer of financial assets (under clauses 6 or 7 of Schedule 1) is excluded from the requirements under the

Corporations Act in order to ensure flexibility in relation the interaction of the Fund and other policy priorities. *[Part 3, subsection 21(1)]*

5.33 If the Board has entered into a securities lending arrangement and under this arrangement the Board must re-acquire a financial asset it lent or acquire an identical asset at some point in the future, these assets are effectively treated as having never been disposed of by the Board — that is, these lent financial assets are included in the calculation of the Board's stake under the Financial Sector (Shareholdings) Act. *[Part 3, subsection 22(3)]*

5.34 If for some reason the Board has not complied with section 606 of the Corporations Act (as amended) or the limits under subsection 22(1), this does not make the transactions invalid. The aim of this provision is to ensure third parties are not adversely affected by the Board's non-compliance. *[Part 3, subsections 21(3) and 22(4)]*

Borrowing

5.35 The Board cannot borrow except for short-term borrowing associated with the settlement of transactions or any circumstances listed in the regulations for the purposes of this section. The eligibility of short-term borrowing for transaction settlement is consistent with the treatment of superannuation funds under the *Superannuation Industry (Supervision) Act 1993*. These restrictions ensure that the Board is able to operate efficiently without exposing the budget to undue risk. *[Part 3, section 23]*

5.36 Regulations may be made to specify circumstances in which it is considered appropriate for the Board to be able to borrow. Regulations may also be used to clarify any uncertainty on whether a particular activity constitutes borrowing. *[Part 3, subsection 23(3)]*

- While it is not anticipated that the Board will have a need to borrow, this provision allows for unforeseen events or changes in the investment environment without the need for amending the legislation. Regulations would be disallowable by Parliament.

Investment policies

5.37 The Board is required to publish and comply with a number of policies on its investment activities. In particular, the Board is required to develop and publish a policy on:

- the strategy it is adopting for the investment of the Fund — this is expected to include, inter alia, the strategic asset allocation for the Fund;

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- how it proposes to manage risks associated with investments of the Fund;
- the benchmarks and standards the Board uses for assessing the performance of the investments of the Fund in general, the performance of any investments it wishes to identify separately, and the performance of certain classes of investments;
- matters for which international best practice dictates the Board should have a policy. This may include matters such as how the Board will exercise any voting rights that are connected with the investments of the Fund; and
- other matters that are specified in the regulations. *[Part 3, subsections 24(1) and 24(7)]*

5.38 Under subsection 33(3) of the Acts Interpretation Act, the Board is able to repeal, rescind, revoke, amend, or vary any such policies. *[Part 3, subsection 24(1), note]*

5.39 The policies that the Board develops must not be incompatible with the investment mandate. *[Part 3, subsection 24(2)]*

5.40 The Board must publish the first set of policies on the Internet as soon as is practicable following the commencement of section 24 of the Act (determined by proclamation). *[Part 3, subsection 24(4)]*

5.41 The Board must conduct reviews of these policies periodically and when the responsible Ministers change the investment mandate *[Part 3, subsections 24(5) and 24(6)]*. It is not expected that these reviews would be a formal process or that the results of the reviews would be required to be published. However, if the review resulted in any changes to the policies, the updated policies would need to be published on the Internet. *[Part 3, subsection 24(3)]*

5.42 If the Board enters into a transaction which is not consistent with a policy that it has published under this section, the transaction is still a valid transaction *[Part 3, subsection 24(8)]*. This ensures that third parties are not affected by any inconsistency with the Board's policies. However, the Board is required to take all reasonable steps to comply with the policies it develops under subsection 24(1) *[Part 3, subsection 24(7)]*.

5.43 The policies that the Board formulates are not legislative instruments under the LIA because they are of an administrative character. *[Part 3, subsection 24(9)]*

Derivatives

5.44 Derivatives are widely used by financial market participants as a tool for risk management. As the sophistication, size and mobility of capital markets around the world increases, investment managers are looking for more ways to maximise the returns on investments while minimising the volatility of results. The types and volumes of derivatives being traded has grown exponentially as the underlying markets have created demand for these types of instruments.

5.45 Section 25 provides for the Board to make use of derivatives as a risk management tool and to indirectly achieve exposure to assets that it could not otherwise achieve if it were required to invest directly in these assets. The Board may also use derivatives to reduce the transaction cost of achieving required exposures. However, the Board may not use derivatives for speculative purposes or for leverage. *[Part 3, subsection 25(1)]*

5.46 Derivatives must be held in the name of the Board and are taken to be an investment of the Fund. Subsection 17(3) provides that derivatives may be realised by the Board. *[Part 3, subsections 17(3) and 25(4)]*

5.47 The Board must formulate a policy on its investment strategy and take all reasonable steps to comply with this policy. The acquisition of derivatives under this section cannot be inconsistent with this strategy. This means that if the investment strategy sets an asset allocation, derivative exposure (when added to physical exposure) must not exceed the proposed allocation for each asset class. *[Part 3, paragraph 24(1)(a)]*

Additional financial assets

5.48 If the Board becomes a holder of another financial asset, for example through a capital distribution, that asset becomes an investment of the Fund and is therefore subject to all the restrictions and requirements for investments of the Fund. *[Part 3, section 26]*

Securities lending arrangements

5.49 The Board is able to enter into securities lending arrangements. Lending of securities is commonplace among institutional investors. It may also take collateral as part of a securities lending arrangement. Any collateral it takes is either credited to the Fund Account or becomes an investment of the Fund. *[Part 3, section 27]*

Investment Managers

5.50 The Board is able to hire one or more investment managers [*Part 3, subsection 28(1)*]. Investment manager is defined broadly to include custodians, transition managers and other investment managers. However, the Agency is carved out of this definition as it is expected that investment activities, such as acquiring derivatives or investing money, will be outsourced. [*Part 1, section 5*]

5.51 Unless approved by the responsible Ministers, the Board must use investment managers to invest money in financial assets, acquire derivatives, enter into securities lending arrangements or realise financial assets. The responsible Ministers may provide approval in writing for certain methods of investment other than through investment managers should it be prudent and cost effective to do so. [*Part 3, subsection 28(2)*]

5.52 The Board is required to ensure that in the contracts with the investment managers it ensures that investment managers must operate within the Act and specifies when and how investment managers report on the state of investments of the Fund. [*Part 3, subsections 28(3) and 28(4)*]

Custody of securities

5.53 Section 40 of the FMA Act does not apply to investments of the Fund. This means that officials who receive any bonds, debentures or other securities in the course of their duties are not required to deal with them in accordance with the Finance Minister's Orders. [*Part 3, section 29*]

5.54 Section 40 of the FMA Act is designed for departments of state who carry out a more limited range of investment activities than is envisaged for the Fund. Further, making custodians and other investment managers comply with the Finance Minister's Orders for investment purposes could impose an undue administrative burden.

5.55 While section 40 of the FMA Act is excluded, a framework for how the Board must deal with securities that it receives is covered by sections 17 and 27.

Exemption from taxation

5.56 To avoid any doubt, subsection 30(1) makes the income of the Board exempt from income tax under the *Income Tax Assessment Act 1997* ('the ITAA 97'). This is consistent with the general principle that entities within the General Government Sector are not subject to income tax. The Board is subject to notional fringe benefits tax and goods and services tax.

5.57 Subsection 30(2) clarifies that the Board is not subject to tax under a law of a State or Territory, such as stamp duty, if the Commonwealth is not subject to the tax.

Franking credits

5.58 In addition, the Board is deemed to be an exempt institution that is eligible for a refund of franking credits under the ITAA 97 [Part 3, section 31]. As the Board is exempt from income tax it may have an investment bias towards assets whose return had not previously been subject to income tax (such as debt instruments or unfranked dividends). Refunding franking credits removes the potential bias against franked dividends.

5.59 This section effectively modifies the operation of section 207-115 of the ITAA 97, which details which tax exempt institutions are eligible for a refund of franking credits attached to a franked distribution.

5.60 In order to determine the Board's entitlement to a refund, the assets held in the name of the Board but on behalf of the Commonwealth, are treated as if they were held by the Board in its own right. Any refund received is credited to the Fund Account. [Part 3, subsections 31(3) and 31(4)]

Realisation of non-financial assets

5.61 If the Board holds an asset which was mistakenly acquired by the Board or given to the Board or which ceases to be a financial asset due, for example, to a revision of the ABS government finance statistics manual, the Board must realise that asset as soon as is practicable. [Part 3, paragraphs 32(1)(a) and 32(2)(a)]

5.62 The Act treats this asset as a financial asset up to the time it is realised. This ensures that the asset is considered an investment of the Fund for that period and that the other rules in the Act relating to investments of the Fund apply to that asset for the time it is held by the Board. [Part 3, paragraphs 32(1)(b) and 32(2)(b)]

6

Part 4 — The Future Fund Board of Guardians

Division 1 — Introduction

Simplified outline

6.1 The simplified outline is intended to provide a high level introduction to the contents of this Part of the Act in order to aid readability. *[Part 4, section 33]*

Division 2 — Establishment and functions of the Future Fund Board of Guardians

Establishment of the Future Fund Board of Guardians

6.2 Section 34 establishes the Future Fund Board of Guardians.

Board's functions

6.3 Section 35 establishes the Board's functions. It provides that the Board is responsible for making decisions in relation to the investment management of the Fund in accordance with the Act and directions given under the Act (including the Government's investment mandate). *[Part 4, paragraph 35(a)]*

6.4 It also clarifies that the Board's functions include other functions that are provided for by the Act, such as providing annual reports and financial statements, and to do anything incidental or conducive to its performance in relation to those functions. *[Part 4, paragraphs 35(b) and 35(c)]*

Board's ordinary powers

6.5 The Board has the power to do all things necessary or convenient to ensure the Board can perform its functions [Part 4, subsection 36(1)]. However, the Board cannot hold money or real or personal property in its own right — all money and real or personal property is held for and on behalf of the Commonwealth [Part 4, subsections 36(3) and 36(4)]. The Board cannot lease land or buildings for the purposes of the Board [Part 4, subsections 36(1)]. Instead it is one of the Agency's functions to make appropriate resources and facilities available to the Board. [Part 5, subsection 74(e)]

6.6 The Board may enter into contracts (including contracts of insurance), however, as the Board cannot hold money in its own right, the Board cannot be liable to pay an amount to a person and the Commonwealth is instead responsible for discharging any such liabilities from the fund. [Part 4, subsection 36(2)]

Board is a body corporate

6.7 Section 37 provides that the Board is a body corporate with perpetual succession. It is therefore a separate legal identity to the Commonwealth. [Part 4, paragraph 37(1)(a)]

6.8 It is also able to acquire, hold and dispose of real and personal property, however, this does not provide for the Board to hold real and person property (including money) in its own right. [Part 4, paragraph 37(1)(c) and subsections 36(3) and 36(4)]

6.9 The Board is required to have a seal. The Board is able to sue and be sued in the name of the Future Fund Board of Guardians. [Part 4, paragraphs 37(1)(b) and 37(1)(d)]

6.10 The Board's seal is to be kept in safe custody and cannot be used unless authorised by the Board. [Part 4, subsection 37(2)]

6.11 All courts, judges and other persons acting in a legal capacity are required to take judicial notice of the imprint of the Board's seal on a document and make the assumption that the imprint was appropriately affixed. [Part 4, subsection 37(3)]

Membership

6.12 The Board consists of a Chair and six other members. [Part 4, subsection 38(1)]

The Future Fund Board of Guardians

6.13 Consistent with subsection 33(2B) of the Acts Interpretation Act, the performance of the functions, or the exercise of the powers of the Board is not affected by there being a vacancy or vacancies in the membership of the Board.

6.14 Members are appointed in writing by the responsible Ministers. *[Part 4, subsection 38(2)]*

6.15 Given the expected quantum of funds under the Board's management, it is important to have well qualified Board members. Consequently, a person cannot be appointed as a Board member unless he or she appears to the responsible Ministers to be qualified for appointment because of his or her reputation in and knowledge of, or experience in, one or more of the following areas:

- investing in financial assets, which may include, but is not limited to:
 - broad experience in investing in domestic and international financial markets;
 - setting strategic asset allocation as an investment practitioner or in the management of superannuation funds; or
 - a professional accreditation and standing amongst peers, including relevant qualifications in finance.
- the management of investments in financial assets, which may include, but is not limited to:
 - experience in developing and/or implementing industry best practice; or
 - specialist knowledge of specific asset classes and/or markets.
- corporate governance, which may include, but is not limited to:
 - general corporate governance issues that arise in the private sector, such as experience in change management;
 - experience in providing leadership and strategic direction to an organisation;
 - membership of government advisory boards, regulatory bodies and/or other statutory boards; or
 - experience in undertaking independent reviews and/or preparing impartial reports to government. *[Part 4, subsection 38(3)]*

6.16 Full-time Commonwealth office holders, and Commonwealth public sector employees (whether full-time or part-time employees) are not eligible for Board appointments. This is consistent with the better practice guidance for boards contained in the Uhrig Review. However, people who hold a part-time office under a Commonwealth law, such as part-time members of another statutory board, are eligible for appointment. The note clarifies that Board members (including the Chair even though he or she is head of the Agency) are office holders rather than employees and are therefore eligible for reappointment. *[Part 4, subsection 38(4)]*

Application of the Corporations Act 2001

6.17 In applying the Corporations Act, the Board is taken to be an exempt public authority, which means that under section 57A of the Corporations Act it is excluded from the definition of ‘corporation’ and provisions relating to corporations under the Corporations Act do not apply. *[Part 4, subsection 39(1)]*

6.18 Further, subsection 39(2) makes it clear that the Board is considered an instrumentality of the Crown for the purposes of section 5A of the Corporations Act *[Part 4, subsection 39(2)]*. The Board is therefore not bound by Chapter 5 (except Part 5.8) but is bound by chapters 6, 6A, 6B, 6C and 6D of the Corporations Act and is bound by a provision of chapters 6CA and 7 if specified in regulations under that Act.

Division 3 — Terms and conditions for Board members

Term of appointment and related matters for Board members

6.19 Board members are part-time rather than full-time. A member holds office for the period specified in his or her instrument of appointment. This period cannot exceed five years. The Uhrig Review supported finite board terms and suggested that appointments to statutory authorities generally be limited to terms of three years. In order to allow for continuity of management and appropriate transfer of corporate knowledge on the Board, it is considered that appointments of up to five years are appropriate for the Future Fund Board of Guardians, especially in the early stages. *[Part 4, section 40]*

6.20 As a result of subsection 33(4A) of the Acts Interpretation Act, which provides that in any Act ‘appoint’ includes ‘re-appoint’, a Board member is able to be reappointed for a further period of up to five years. Therefore, with reappointment, the individual’s total period of membership may exceed five years. *[Part 4, subsection 40(2), note]*

6.21 The definition of Chair includes a person who is acting as Chair of the Board, consistent with section 33A of the Acts Interpretation Act.

Remuneration and allowances of Board members

6.22 The Remuneration Tribunal sets the remuneration and entitlements of Board members, which are paid out of the Fund. If no determination of the Remuneration Tribunal is in place, the Board member is paid remuneration determined by the responsible Ministers. *[Part 4, subsection 41(1)]*

6.23 Board members are paid the allowances that are prescribed by the Remuneration Tribunal. *[Part 4, subsection 41(2)]*

6.24 Section 41 operates subject to the *Remuneration Tribunal Act 1973*, which provides for the Remuneration Tribunal to conduct inquiries and make determinations on the remuneration of certain office holders. That is, if remuneration determined or prescribed under this Act conflicts with a determination by the Remuneration Tribunal, the latter determination applies. *[Part 4, subsection 41(3)]*

Leave of absence of Board members

6.25 The nominated Minister may grant the Chair leave of absence on such terms and conditions as to remuneration or otherwise as the Minister determines. *[Part 4, subsection 42(1)]*

6.26 The Chair may grant another member leave of absence on such terms and conditions as to remuneration or otherwise as the Chair determines. *[Part 4, subsection 42(2)]*

Resignation of Board members

6.27 A Board member may resign by way of a signed document sent to the Minister. No time limit applies to this notice of resignation. *[Part 4, section 43]*

Termination of appointment of Board members

6.28 The responsible Ministers may terminate the appointment of a member if the responsible Ministers are of the opinion that the member's performance has been unsatisfactory for a significant period of time *[Part 4, paragraph 44(2)(e)]*. Similarly, the responsible Ministers have the discretion to terminate the appointment of a Board member on the grounds of misbehaviour or physical or mental incapacity. *[Part 4, subsection 44(1)]*

6.29 In addition, the responsible Ministers may terminate the appointment of a Board member if:

- the member becomes bankrupt, applies for relief from bankruptcy, enters into an arrangement with creditors regarding the payment of his or her debts or assigns all or part of his or her remuneration for the benefit of creditors;
- the member fails, without reasonable excuse to disclose interests which may potentially conflict with the performance of their functions of office;
- the member does not attend three consecutive meetings of the Board and is not on a leave of absence during that time;
- the member fails to perform his or her duties; or
- the responsible Ministers consider that the Board member's performance has been unsatisfactory for a significant period of time. *[Part 4, subsection 44(2)]*

Other terms and conditions of Board members

6.30 The responsible Ministers may determine other terms and conditions for Board members in addition to those covered by this Act. *[Part 4, section 45]*

Acting Board members

6.31 The nominated Minister is empowered to appoint a person to act as the Chair during a vacancy in the office of Chair or during any period, or during all periods, when the Chair is absent from duty or from Australia or is, for any reason, unable to perform the duties of the office. It is expected that this person would be an existing Board member but it is open to the nominated Minister to appoint a non-Board member as acting Chair. *[Part 4, subsection 46(1)]*

6.32 The nominated Minister is also empowered to appoint a person to act as a member (other than as Chair) during a vacancy in the office of a member or during any period, or during all periods, when a member is absent from duty or from Australia or is, for any reason, unable to perform the duties of the office. *[Part 4, subsection 46(2)]*

6.33 However, a person is only eligible to act as Chair of the Board or as a Board member if he or she would have been eligible for appointment as a Board member under section 38. For example, the person is not eligible if he or she is an employee of the Commonwealth or if he or she does not have the appropriate reputation and expertise. *[Part 4, subsection 46(3)]*

6.34 A defect or irregularity in connection with a person's appointment to act under section 46 will not invalidate anything done by the person when purporting to act under this section, and will not invalidate that person's appointment. For example, this provision would cover a situation in which a person is acting because a Board member was going to be overseas but the Board member was able to get an earlier flight and was in fact in Australia at the time of the meeting. *[Part 4, subsection 46(4)]*

6.35 Section 33A of the Acts Interpretation Act contains further provisions dealing with acting appointments which are relevant to acting appointments made under section 46 *[Part 4, subsection 46(4), note]*. The effect of these provisions is that:

- an acting appointment may be expressed to have effect only in the circumstances specified in the instrument of appointment;
- the appointer may determine the terms and conditions of the appointment, including remuneration and allowances and terminate the appointment at any time;
- where the appointment is to act in a vacant office, the appointee must not continue to act in the office for more than 12 months;
- where the appointee is acting in an office other than a vacant office and the office becomes vacant while the appointee is acting then, unless his or her instrument of appointment provides otherwise, the appointee may continue to act until the appointer otherwise directs, the vacancy is filled, or a period of 12 months from the day the vacancy ends, whichever happens first;
- the appointment ceases to have effect if the appointee resigns in writing directed to the appointer; and
- while the appointee is acting in the office, he or she has and may exercise all the powers, and is to perform all the functions and duties, of the holder of the office and this Act and any other legislation will apply in relation to the appointee as if the appointee were the holder of the office.

Division 4 — Meetings

Holding of meetings

6.36 The Board is to hold meetings as necessary for the efficient performance of its functions. *[Part 4, subsection 47(1)]*

6.37 The general rule is that meetings are to be held at such times and places as the Board determines. This rule is subject to the following qualifications:

- The Chair may call a meeting at any time; and
- The Chair must call a meeting if requested to do so in writing by another Board member. A meeting must be held within 30 days after receiving the written request. *[Part 4, subsection 47(2)]*

Who is to preside at a meeting

6.38 The Chair is to preside at meetings of the Board. However, if the Chair is absent, the Chair can nominate a Board member to preside at the meeting. If the Chair has not nominated a Board member to preside, the Board members that are present at the meeting may elect a member to preside at the meeting. There is no restriction on which Board members are eligible to preside at meetings in this instance. (Note: the term ‘Chair’ includes a person acting as Chair.) *[Part 4, section 48]*

Quorum

6.39 Five Board members constitute a quorum for a meeting of the Board. *[Part 4, subsection 49(1)]*

6.40 It is open to the Board to permit its members to participate in a meeting or all meetings of the Board by telephone, closed-circuit television or any other means of communications. A member who participates in a meeting in such a manner is taken to be present at the meeting (see section 33B of the Acts Interpretation Act).

6.41 However, under section 71 a Board member must not, unless permitted by the Board or responsible Ministers, participate in the deliberations or decisions of the Board on a matter for which that member has an interest. If this requirement results in a quorum no longer being present, the remaining Board members will constitute a quorum providing there are at least three Board members who are physically present and able to participate in the deliberations or decisions of the Board. If there are only one or two people available to attend the meeting then it is open to the Board to pass a resolution without a meeting. *[Part 4, subsection 49(2)]*

Example 1

Assume the Board consists of the following seven members: Angus, Bec, Chris, Daniel, Eve, Flavio and Geetu.

However, Angus and Bec are unable to attend a meeting. Further, if Daniel and Geetu have a conflict of interest in respect of a matter that will be discussed at the meeting, there is no longer a quorum as only Chris, Eve and Flavio are able to participate.

In this circumstance, subsection 49(2) provides that there will still be a quorum as there are at least three Board members physically present who are able to participate.

Voting

6.42 Questions at meetings are to be decided by a majority of the votes of the members present. The person presiding at a meeting has a deliberative and, if necessary, a casting vote – that is, the deciding vote when the votes on each side are equal. *[Part 4, section 50]*

Records of meeting

6.43 The Board must keep minutes of its meetings. *[Part 4, section 51]*

Division 5 — Resolutions without meetings

Resolutions without meetings

6.44 Section 52 allows the Board to determine that resolutions can be made without a meeting of the Board on a particular matter or range of matters.

6.45 If the Board determines that it may make resolutions without a meeting and determines a method by which members can indicate their agreement, a resolution relating to a particular matter or matters is taken to have been passed at a meeting of the Board if:

- without a meeting of the Board, a majority of members eligible to participate indicate their support of the resolution in accordance with the method determined by the Board;
- the majority would have constituted a quorum if the matter had been discussed at a meeting of the Board; and
- all members were informed of the proposed resolution, or reasonable efforts had been made to inform them of it. *[Part 4, subsection 52(1)]*

6.46 A Board member is not entitled to participate in such a resolution if he or she has a conflict of interest under sections 68 or 69. This is consistent with the treatment of conflicts of interest where the matter is discussed at a meeting. *[Part 4, subsection 52(2)]*

Record of resolutions

6.47 The Board is required to keep a record of resolutions that are made without a meeting in accordance with section 52. *[Part 4, section 53]*

Division 6 — Reporting obligations

Nominated Minister may require Board to prepare reports or give information

6.48 The nominated Minister may write to the Board requiring the Board to prepare a report or information on certain matters relating to the performance of the Board. This report or information must be provided within the timeframe outlined in the nominated Minister's request. *[Part 4, section 54]*

6.49 The nominated Minister may choose to publish this report or information. *[Part 4, subsection 54(4)]*

6.50 Such reports and documents are of an administrative nature and the ability to request reports or information by written notice is therefore not a legislative instrument under the LIA. *[Part 4, subsection 54(5)]*

Keeping the responsible Ministers informed etc

6.51 Section 55 requires the Board to notify the responsible Ministers of any information the responsible Ministers should know, including by providing any written information to the nominated Minister. This could include significant investment results, concerns regarding fraud and any non-compliance with the Board's policy on conflicts of interest. *[Part 4, section 55]*

Division 7 — Duties of Board members etc.

Duties of Board members

6.52 Division 7 imposes duties on Board members modelled on sections 22 to 27D of the *Commonwealth Authorities and Companies Act 1997* ('the CAC

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Act'), including the existing civil and criminal penalty provisions. The provisions of the CAC Act are in turn based on parts of the Corporations Act.

- Sections 56 to 59, relating to Board member's civil obligations, correspond to sections 22 to 25 of the CAC Act.
- Sections 60 to 62, which provide that certain actions of Board members constitute a criminal offence, correspond to section 26 of the CAC Act.
- Section 63, which clarifies that (amongst other things) the Chair does not breach their duties by doing something that is required of them under another provision of the Act or the FMA Act and Regulations, corresponds to section 27A of the CAC Act.
- Section 64 corresponds to section 27B of the CAC Act in relation to the interaction between the Board's duties and other laws.
- Section 65 corresponds to section 27D of the CAC Act, which provides when it is reasonable that a Board member may rely on information or advice provided by others.
- Section 66 clarifies that subsections 6(2), 6(3) and 6(4) and section 27C and Schedule 2 of the CAC Act apply to the Board and outlines how these sections are to be interpreted in respect of the Board.

Civil obligations — Care and diligence, good faith, use of position and use of information

6.53 Board members are required to exercise the same degree of care and diligence as a reasonable person would exercise in an equivalent position. *[Part 4, subsection 56(1)]*

- A breach of duty of care and diligence will only give rise to civil sanctions and will not be a basis for an offence under the law.

6.54 A business judgement rule offers Board members a safe harbour from personal liability for breaches of the duty of care and diligence in relation to honest, informed and rational business judgements. *[Part 4, subsection 56(2)]*

6.55 Arriving at a collective decision to invest the Fund in a certain way, all Board members must individually be satisfied that the decision is being taken in good faith, based on sound information and in the best interests of the Board and that they personally do not have a conflict of material personal interest which prevents them from participating in the decision.

6.56 Board members are required to assent only to decisions that they consider to be in the best interests of the Board. The Board's interests are best served where decisions enable the Board to discharge its obligations and responsibilities in a manner acceptable to Parliament (as outlined in the Act) and the Government (as articulated in the investment mandate and other directions). *[Part 4, sections 56 and 57]*

- For example, Board members must be able to attest that the Board's investment decisions are consistent with the Board's statutory obligation to maximise Fund returns over the long term consistent with international best practice for institutional investment.

6.57 Board members and staff of the Agency have an obligation not to use their position, and any information associated with that position, to gain advantage for themselves (or someone else) or to cause detriment to the Board (or another person). *[Part 4, section 58 and 59]*

6.58 The obligation not to misuse information extends beyond the Board member's term of appointment, or staff member's employment with the Agency, to ensure that an individual cannot use information obtained during their membership or employment for their own gain once their appointment ceases. *[Part 4, section 59]*

Criminal offences

6.59 In addition to the civil obligations discussed above, a failure by a Board member to act in good faith, any misuse of the Board member's position or information associated with their position are all criminal offences. If a staff member of the Agency misuses his or her position or information associated with that position, this is also a criminal offence. Breaches of these provisions with a dishonest intent amounts to an offence punishable by a maximum penalty of five years imprisonment. *[Part 4, section 60 to 62]*

6.60 However, a Board member does not contravene their responsibilities or commit an offence under sections 60, 61 or 62 if he or she performs an act required of them by this Act or, for in respect of the Chair, under the FMA Act and Regulations. *[Part 4, section 63]*

Interaction of sections 56 to 62 with other laws etc

6.61 Section 64 confirms that sections 56 to 62 have effect in addition to, and not to the exclusion of, any other laws governing these duties. In addition, the Act does not prevent an action being taken against a Board member or staff member of the Agency under another law. *[Part 4, section 64]*

Reliance

6.62 Board members are expressly allowed to rely on the advice or information provided by experts when making decisions as long as the board member believes on reasonable grounds that the person relied upon is reliable and competent in relation to the matters concerned. *[Part 4, section 65]*

Consequences of breach of duty — additional effect of the Commonwealth Authorities and Companies Act 1997

6.63 This section applies subsections 6(2), (3) and (4), section 27C and Schedule 2 of the CAC Act to the Board, with minor modifications. *[Part 4, section 66]*

Insurance for certain liabilities of Board members

6.64 The section allows the Board to purchase insurance cover in relation to any liabilities incurred by a Board member, except where a liability is the result of an unlawful action (such as a breach of the Board member's duties). *[Part 4, section 67]*

Division 8 — Conflict of Interests

Material personal interest – Board member's duty to disclose

6.65 Section 68 provides for the disclosure by a Board member of any material personal interest the Board member may have in a matter that is being considered, or about to be considered by the Board.

6.66 Subsection 68(2) states there are some conditions under which a Board member does not need to give notice of a material personal interest.

6.67 Subsection 68(3) imposes a standing obligation on Board members to disclose all potential conflicting material interests in writing to the Board as soon as possible after the Board member becomes aware of any potential for conflict. This notification must be recorded in the minutes of the meeting.

Board member may give other Board members standing notice about an interest

6.68 Subsection 69(1) and 69(2) states that a member who has a material personal interest that could conflict with the proper performance of the functions of his or her office may give the Board standing notice of the nature

and extent of the conflict of interest. The notice must give details of the extent of the material interest either orally or in writing at a Board meeting or in writing to each individual Board member.

6.69 Any notices given under subsections 69(1) and 69(2) have effect as soon as the notice is provided but ceases to have effect once a new Board member is appointed or the nature and extent of the interests increases materially.

Interaction of sections 68 and 69 with other laws

6.70 Section 70 confirms that sections 68 to 69 have effect in addition to, and not to the exclusion of, any other laws governing the disclosure of conflict of interests. In addition, the Act does not prevent an action being taken against a Board member under another law. *[Part 4, section 70]*

Restrictions on voting and Ministerial power to make declarations and class orders

6.71 Section 71 provides that if a Board member has a material personal interest they are not permitted to be present while the matter is being considered or vote on the matter unless otherwise approved by the responsible Ministers or other Board members. Where a Board member contravenes this section, any resolutions of the Board made with the Board member's involvement remain valid. *[Part 4, section 71]*

6.72 Section 72 allows the responsible Ministers to make an order that despite an individual Board member's interests, they may participate in discussions of, and vote on, a matter. However, an order can only be made if there otherwise would not have been a quorum and the matter needs to be dealt with urgently. Such an order is not legislative in nature and is therefore not a legislative instrument for the purposes of the LIA. *[Part 4, section 72]*

6.73 The responsible Ministers may also make a class order for specified classes of members, resolutions or interests to enable Board members to participate even if they have a conflict of interests. This order is also not legislative and is therefore not a legislative instrument. *[Part 4, section 72]*

7

Part 5 — The Future Fund Management Agency

Division 1 — Introduction

Simplified outline

7.1 The simplified outline is intended to provide a high level introduction to the contents of this Part of the Act in order to aid readability. *[Part 5, section 73]*

Division 2 — Establishment and functions of the Future Fund Management Agency

Establishment of the Future Fund Management Agency

7.2 Subsection 74(1) establishes the Future Fund Management Agency ('the Agency'). The Agency comprises the Chair of the Future Fund Board of Guardians and staff of the Agency. The Agency does not have a separate legal identity to the Commonwealth. *[Part 5, section 74]*

Functions of the Agency

7.3 The functions of the Agency are to provide executive support to the Board. The Agency is responsible for the operational activities associated with the Fund, including acting on the investment decisions of the Board. It is also responsible for advising the Board, leasing premises for the Board, organising Board meetings, providing administrative services and doing anything incidental or conducive to the performance of its functions under the Act.

However, the Agency must act consistently with any directions or policies provided by the Board. *[Part 5, section 75]*

Division 3 — Management and staff of the Future Fund Management Agency

Duties of the Chair

7.4 The Chair of the Board is also the Head of the Agency. *[Part 5, section 76]*

7.5 The Chair is ultimately responsible for the day-to-day operation of the Agency. However, the Chair is appointed on a part-time basis and is expected to delegate to a full-time general manager. Anything the Chair does on behalf of the Agency (including in the name of the Agency) is considered to have been done by the Agency. *[Part 5, section 76]*

7.6 The intention is to prescribe the Future Fund Management Agency under the FMA Act. The Chair may then delegate his or her financial powers under the FMA Act. The Chair may also delegate his or her staffing powers under the Public Service Act.

7.7 Allowing the Head of the Agency to delegate his/her powers or functions to officials who would undertake the tasks concerned is a normal administrative arrangement. It is envisaged that the Chair would be held accountable by the responsible Ministers for managing, monitoring and controlling the activities of those officials who perform the tasks under delegation.

Staff of the Agency

7.8 Section 77 provides for the appointment of staff for the Agency. The Agency's staff consists of persons engaged under the Public Service Act. *[Part 5, subsection 77(1)]*

7.9 In applying the Public Service Act, the Chair and staff of the Agency constitute a 'Statutory Agency'. The Chair is the Head of this statutory agency. *[Part 5, subsection 77(2)]*

Consultants and persons seconded to the Agency

7.10 Section 78 empowers the Chair to engage consultants to provide services in connection with the functions of the Agency or the Board. This could include the provision of advisory services. Consultants are not restricted

to individuals and can include companies. Consultants are engaged under the terms and conditions specified by the Chair in writing. *[Part 5, section 78]*

7.11 Officers and employees of other Public Service Agencies or authorities and companies of the Commonwealth may assist the Agency in the performance of any of its functions. *[Part 5, subsection 78(3)]*

Chair not subject to direction by the Board on certain matters

7.12 Section 79 makes it clear that the Board may not direct the Chair in relation to the Chair's performance of functions, or exercise of powers, as Chief Executive under the FMA Act or as Agency Head under the Public Service Act. The purpose of this section is to avoid possible conflicts between the Chair's powers and responsibilities as head of the Agency and the Agency's requirement to follow decisions made by the Board. *[Part 5, section 79]*

Division 4 — Other provisions

Application of the Financial Management and Accountability Act 1997

7.13 The intention of section 80 is for the Board and Agency to be considered, and treated, as if they were a single agency for financial reporting purposes and that such reports be prepared in accordance with the FMA Act. The aim is to avoid any unnecessary duplication in reporting and recognise that the Board does not hold money on its own account, but instead exercises its functions, for and on behalf of the Commonwealth. For example, this provision makes it clear that there will be one set of audited financial statements prepared to cover the activities of the Board and the Agency in relation to the Fund. *[Part 5, section 80]*

Annual report

7.14 The Chair must prepare an annual report and provide this report to the nominated Minister as soon as practicable after the end of a financial year. The annual report must cover:

- the operations of the Agency;
- the operations of the Board; and
- the performance of the investments of the Fund.

It must also include details on, and a benchmark of, expenses relating to:

- remuneration and allowances of Board members;
- remuneration and other employment-related costs of the staff of the Agency;
- contracts with investment managers;
- consultants to the Agency and persons seconded to the Agency;
- consultants and advisers to the Board; and
- the establishment and operation of the Agency. *[Part 5, subsections 81(1) and 81(2)]*

7.15 The purpose of requiring benchmarking of expenses is to ensure comparative scrutiny of the costs of operation. The reporting of benchmarks such as management expense ratios is commonplace in the investment community.

7.16 As with financial reporting covered in section 80, a consolidated annual report covering the Board and Agency will avoid duplication and enable Parliament, and the public, to gain a holistic view of the Fund.

7.17 The nominated Ministers must table the report in each House of Parliament within fifteen sitting days of receiving the report. This is consistent with section 34C of the Acts Interpretation Act. *[Part 5, subsection 81(3)]*

Consultants and advisers to the Board

7.18 Section 82 provides for the Chair, on behalf of the Commonwealth, to engage suitably qualified people as consultants for, or advisers to, the Board. The terms and conditions of any engagements are as specified in writing by the Chair. *[Part 5, section 82]*

8

Part 6 — Miscellaneous

Nominated Minister

8.1 The responsible Ministers must agree that one of them (that is, either the Treasurer or the Finance Minister) is the ‘nominated Minister’. This decision affects the operation of:

- Section 42 — Leave of absence of Board members;
- Section 46 — Acting Board members;
- Section 54 — Nominated Minister may require Board to prepare reports or give information;
- Section 55 — Keeping the responsible Ministers informed etc;
- Section 81 — Annual report;
- Schedule 1, clause 5 — Credit of amounts to the Fund Account — gifts;
- Schedule 1, clause 6 — Transfers to the Fund — Commonwealth-owned financial assets;
- Schedule 1, clause 7 — Transfers of financial assets to the Fund — gifts;
- Schedule 1, clause 8 — Ministerial directions about transferred financial assets;
- Schedule 1, clause 9 — Continuing effect of instruments relating to transferred financial assets;
- Schedule 3, clause 2 — Designated actuary; and

- Schedule 3, clause 3 — Target asset level declarations.

8.2 The effect of this is that only the nominated Minister (rather than both Ministers) is required to cause relevant information to be published or approve a leave of absence of the Chair, acting appointments for the Board or seek additional information or reports from the Board. In addition, the Board only needs to provide information to the nominated Minister, rather than both Ministers. This is intended to streamline and simplify these processes. Other sections of the Act require decisions from both Ministers and reports to be provided to both Ministers. *[Part 6, section 83]*

8.3 The nominated Minister may provide the other responsible Minister with information he or she has received in his or her capacity as nominated Minister. *[Part 6, subsection 83(4)]*

8.4 The determination is of an administrative nature and therefore not a legislative instrument under the LIA. *[Part 6, subsection 83(3)]*

Miscellaneous receipts to be credited to the Fund Account

8.5 Any receipts of money received by the Board, such as a payout under an insurance contract that is not otherwise covered by this Act are to be credited to the Fund Account. *[Part 6, section 84]*

Regulations

8.6 The Governor-General may make regulations under section 85 covering matters required to be prescribed in the Act, or matters that it would be convenient to prescribe for the purposes of this Act. *[Part 6, section 85]*

9

Schedule 1 — Credits of amounts, and transfers of financial assets, to the Future Fund

Part 1 — Introduction

Simplified outline

9.1 The simplified outline is intended to provide a high level introduction to the contents of this Schedule in order to aid readability. [*Schedule 1, Part 1, clause 1*]

Part 2 — Credits of amounts to the Future Fund

Credit of \$18 billion to the Fund Account

9.2 The Government's initial contribution to the Fund, or seed capital, is \$18 billion. This amount is sourced from the 2004-05 surplus and from previously realised surpluses currently held as deposits with the Reserve Bank.

9.3 The initial contribution must be credited to the Fund Account through a determination by the responsible Ministers before 1 July 2006 [*Schedule 1, Part 2, clause 2*]. The contribution can be credited either in one lump sum or in instalments [*Schedule 1, Part 2, subclause 2(1)*].

9.4 The determination for crediting the initial contribution to the Fund Account cannot be revoked. [*Schedule 1, Part 2, subclause 2(3)*]

9.5 The determination is deemed to be a legislative instrument for the purpose of the LIA and is therefore required to be tabled in Parliament and published on the Federal Register of Legislative Instruments. However, the determination, as a ministerial direction, is not disallowable. [*Schedule 1, Part 2, subclause 2(4)*]

Credits of additional amounts to the Fund Account – Ministerial determinations

9.6 The Government's policy is to make transfers to the Fund on an ex-post basis — that is, out of realised surpluses or proceeds from asset sales and subject to other policy priorities. Consistent with the principle of an ex-post Fund, the Act does not require ongoing contributions to the Fund or mandate that the Fund must reach a certain level at a particular time.

9.7 Transfers of amounts to the Fund are permitted provided that the transfer does not increase the balance of the Fund above the target asset level that is in force at the time of the transfer [*Schedule 1, Part 2, clause 3*]. Target asset levels are explained in Schedule 3 of this Explanatory Memorandum.

- This approach reinforces that the Fund is designed to accumulate assets for a defined purpose (making provision for unfunded superannuation liabilities) and ensures that the Fund cannot be used as a vehicle to accumulate assets significantly in excess of those required for that purpose.

9.8 Transfers of amounts to the Fund, subsequent to the initial contribution, are made through determinations by the responsible Ministers. A target level declaration must be in force before a determination to transfer an amount to the Fund Account is made. [*Schedule 1, Part 2, subclause 3(1)*]

9.9 A transfer of an amount to the Fund can be made either in one lump sum or in instalments. [*Schedule 1, Part 2, subclause 3(1)*]

9.10 The determination made by the responsible Ministers to transfer an amount to the Fund Account nominates a balance day. This balance day is administrative in nature and is used as the reference date for both the measurement of the starting position of the Fund and the valuation date for assets transferred to the Fund. This is to avoid the need to estimate a possible future value for the assets transferred. The currency of the balance day is ensured as it must be a date that is no more than three months before the determination date. [*Schedule 1, Part 2, subclause 3(2)*]

9.11 Before an amount can be transferred to the Fund, a calculation is required to ensure that the target asset level is not exceeded. This calculation commences with the balance of the Fund at the nominated balance day.

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[Schedule 1, Part 2, paragraph 3(2)(a)]. The balance of the Fund on this day is determined from the accounts and records maintained by the Future Fund Management Agency.

9.12 The amount to be transferred to the Fund is then added to the Fund balance as at the balance day [Schedule 1, Part 2, paragraph 3(2)(b)].

9.13 Finally, the value of any assets that have been transferred to the Board since the nominated balance day is added to the Fund balance [Schedule 1, Part 2, paragraph 3(2)(c)]. Including these assets ensures the completeness of the Fund balance for its comparison to the target asset level.

9.14 The revised Fund balance is then compared with the target asset level specified in the target asset level declaration for that financial year. [Schedule 1, Part 2, paragraphs 3(2)(d) and (e)]

Example 2

Data:

- A target asset level declaration is in force covering the period 1 July 2006 to 30 June 2007. The declaration specifies a target asset level for the financial year of \$100 billion.
- Balance day specified in the determination: 29 September 2006. (The balance day meets the currency test as it is not more than three months previous to the determination day.)
- Specified day for credit of amount: 1 November 2006.
- Day on which the determination is to be made: 27 October 2006
- Amount specified in the determination (that is, the amount to be transferred): \$4 billion
- Value of assets still to be transferred under clause 6 of Schedule 1: \$2 billion

Calculation:

Balance of the Fund as at the balance day (29 September 2006)	\$16 billion
Add amount specified in the determination	\$4 billion
Add value of any assets transferred since the balance day	\$2 billion
Updated balance of the Fund	\$22 billion

Result:

\$22 billion is less than the \$100 billion specified in the target asset level declaration for 2006-07 therefore the determination seeking the credit of the \$4 billion to the Fund can proceed.

9.15 Only one determination for the credit of an amount to the Fund can operate at any one point in time. Any such determination may be revoked but cannot be varied. This means that if a determination to credit amounts in instalments is in force and the responsible Ministers wish to credit an additional amount to the Fund Account, they will need to revoke the existing determination and issue a new determination that covers the remaining instalments as well as the additional amount. The revocation of the existing determination does not affect those instalments already made — only those scheduled to be made. *[Schedule 1, Part 2, subclauses 3(3), 3(4) and 4(3)]*

9.16 The responsible Ministers' determination of amounts to be credited to the Fund is deemed to be a legislative instrument for the purpose of the LIA and is therefore required to be tabled in Parliament and published on the Federal Register of Legislative Instruments. However, the determination, as a ministerial direction, is not disallowable. *[Schedule 1, Part 2, subclause 3(5)]*

Duration of subclause 3(1) determinations

9.17 Clause 4 deals with the duration of determinations that credit amounts to the Fund Account and specifies the earliest date that a determination ceases.

9.18 Where a determination provides for the credit of an amount to the Fund Account on only one specified day, the determination ceases at the earliest of the end of that day, the time when the target asset level declaration is no longer active and the time of revocation of the determination (if this occurs). *[Schedule 1, Part 2, subclause 4(1)]*

9.19 Where the determination provides for credits of amounts to the Fund Account on more than one specified day the determination ceases at the earliest of the end of the latest of the specified days, the time when the target asset level declaration is no longer active and the time of revocation of the determination (if this occurs). *[Schedule 1, Part 2, subclause 4(2)]*

Credit of amounts to the Fund Account — gifts

9.20 Clause 5 allows the Board, with the written approval of the nominated Minister, to accept gifts of money. It is envisaged that the use of this clause would be very limited and likely only to be used in relation to the transfer of

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minor residual amounts which may arise in the context of future asset sales.
[Schedule 1, Part 2, subclause 5(1)]

9.21 Any amounts approved as a gift are to be credited to the Fund Account.
[Schedule 1, Part 2, subclause 5(2)]

9.22 It is expected that the nominated Minister will not approve the gift of money if, based on the calculation set out in clause 3, accepting the money would result in the balance of the Fund exceeding the target asset level for that financial year.

Part 3 — Transfers of financial assets to the Future Fund

Transfers to the Fund — Commonwealth-owned financial assets

9.23 The Act provides that the nominated Ministers may transfer Commonwealth-owned financial assets to the Fund and therefore under the management of the Board. Such transfers do not require a Ministerial determination but rather are effected through completion of relevant documentation transferring ownership of the asset from one party to another.
[Schedule 1, Part 3, subclause 6(1)]

9.24 As with transfers of amounts to the Fund, transfers of financial assets are permitted provided the transfer does not increase the balance of the Fund above the target asset level (for the relevant financial year) that is covered by a target asset level declaration in force at the time of the transfer. *[Schedule 1, Part 3, subclause 6(2)]*

9.25 This approach reinforces that the Fund has a defined purpose (making provision for unfunded superannuation liabilities) and ensures that the Fund cannot be used as a vehicle to accumulate assets significantly in excess of those required for that purpose.

9.26 Before assets can be transferred to the Fund, a calculation is necessary to ensure that the target asset level is not exceeded. Therefore a target asset level declaration must be in force *[Schedule 1, Part 3, subclause 6(1)]*. The calculation takes into account several components needed to correctly establish the Fund balance for its comparison against the target asset level.

9.27 The calculation commences with the balance of the Fund at the start of the nominated balance day *[Schedule 1, Part 3, paragraphs 6(2)(a) and 6(6)(b)]*. The responsible Ministers must declare, in writing, a balance day for the assets. This balance day is purely administrative in nature and is used as a reference date for both the measurement of the starting position of the Fund and the valuation date

for assets transferred to the Fund. The currency of the balance day is ensured as it must be a date that is not more than three months before the date of the transfer of the assets.

9.28 The value of the assets to be transferred to the Fund is then added to the Fund balance as at the balance day. The value of these assets is measured as at start of the balance day determined by the responsible Ministers. For purposes of the example calculation, this item is referred to as ‘proposed asset transfers’. *[Schedule 1, Part 3, paragraph 6(2)(b)]*

9.29 The value of any other assets already transferred to the Fund since the balance day is then added *[Schedule 1, Part 3, paragraph 6(2)(c)]*. This ensures that any assets transferred to the Fund but not reflected in the Fund balance at the balance day are taken into account. If these assets were not included in the calculation, the Fund balance may be significantly understated. For the purposes of the example calculation, this item is referred to as ‘assets already transferred’.

9.30 Any amounts that have been credited or are to be credited to the Fund Account are then considered. Amounts may have been credited to the Fund Account under clause 2 or 3 of Schedule 1 since the balance day but before the date of the proposed asset transfers. These amounts must therefore be added to the Fund balance to ensure the completeness of the calculation. For purposes of the example calculation, this item will be referred to as ‘amounts already credited’. *[Schedule 1, Part 3, paragraph 6(2)(d)]*

9.31 Finally, if a determination to credit an amount (or amounts) to the Fund Account under clause 2 or 3 of Schedule 1 is in force at the time the proposed asset transfers are to be made, then any amount scheduled to be credited to the Fund account after the proposed asset transfer must also be taken into account. Again, this is to ensure that all relevant information is taken into account when comparing the Fund balance against the target asset level. For purposes of the example calculation, these amounts will be referred to as ‘amounts scheduled to be credited’. *[Schedule 1, part 3, paragraph 6(2)(e)]*

Example 3

Data:

- A target asset level declaration is in force covering the period 1 July 2007 to 30 June 2008. The declaration specifies a target asset level for the financial year of \$100 billion.
- Balance day specified in the declaration by responsible Ministers: 30 October 2007. (The balance day meets the currency test as it is less than

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three months previous to the day on which the Ministers cause the assets to be transferred.)

- Day on which the responsible Ministers cause the assets to be transferred: 20 November 2007
- Assets transferred since 30 October 2007: \$3 billion
- Amounts credited to the Fund Account since 30 October 2007: \$2 billion
- Amounts scheduled to be credited to the Fund Account after 20 November 2007: \$9 billion
- Value of proposed asset transfer: \$10 billion

Calculation:

Balance of the Fund as at the balance day (30 October 2007):	\$21 billion
Add proposed asset transfers:	\$10 billion
Add assets already transferred:	\$3 billion
Add amounts already credited:	\$2 billion
Add amounts scheduled to be credited:	\$9 billion
Updated balance of the Fund	\$45 billion

Result

\$45 billion is less than the \$100 billion specified in the target asset level declaration for 2007-08 therefore the proposed transfer of assets valued at \$10 billion can proceed.

9.32 Details of assets transferred to the Fund, and the balance day declared by the responsible Ministers, must be published on the Internet as soon as practicable after the transfer is made. Publication of the details of asset transfers provides appropriate transparency and accountability. [*Schedule 1, Part 3, subclause 6(6)*]

9.33 The declaration made by the responsible Ministers relating to the balance day for the assets is not legislative in character and is therefore not a legislative instrument for the purposes of the LIA. [*Schedule 1, Part 3, subclause 6(7)*]

9.34 To avoid doubt subclause 6(5) states that action taken under subclause 6(1) is not a Telstra sale scheme. A Telstra sale scheme is a scheme designed to achieve the transfer, or progressive transfer, of all or part of the Commonwealth's remaining equity in Telstra to other persons. A transfer of Telstra shares to the Fund is not a Telstra sale scheme because the Commonwealth still retains beneficial ownership of the Fund.

- However, under the *Telstra Corporation Act 1991*, any Telstra shares held by the Future Fund are taken to be held by another person for the purpose of determining whether there is an 85% sale day for Telstra. This reinforces that any Telstra shares held by the Board are being managed at arms length from Government.

9.35 A transferred financial asset is regarded as an investment of the Fund [*Schedule 1, Part 3, subclause 6(3)*]. The fact that the asset is transferred rather than acquired by other means does not prevent its realisation under subsection 17(4) or its disposal under a securities lending arrangement entered into under section 27 [*Schedule 1, Part 3, subclause 6(4)*].

Transfers of financial assets to the Future Fund - gifts

9.36 Clause 7 allows the Board, with the written approval of the nominated Minister, to accept gifts of financial assets. It is envisaged that the use of this clause would be very limited and likely only to be used in relation to the transfer of minor residual financial assets arising from the finalisation of future assets sales. [*Schedule 1, Part 3, subclause 7(1)*]

9.37 Any financial asset approved as a gift is taken to be transferred to the Board and is regarded as an investment of the Fund. The fact that the transferred asset has been gifted does not prevent its realisation under subsection 17(4) or its disposal under a securities lending arrangement entered into under section 27. [*Schedule 1, Part 3, subclauses 7(2), 7(3) and 7(4)*]

9.38 It is expected that the nominated Minister will not approve the gift of financial assets if, based on the calculation set out in clause 6, accepting the assets would result in the balance of the Fund exceeding the target asset level for that financial year.

Ministerial directions about transferred financial assets

9.39 Ministers may give directions to the Board regarding assets transferred to the Fund, whether in relation to Commonwealth-owned financial assets or assets transferred for no monetary or non-monetary payment. Such directions allow the Government to appropriately manage any interaction between such transfers and other policy priorities. [*Schedule 1, Part 3, subclause 8(1)*]

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9.40 Directions may be given at the time the financial assets are transferred or some time after. However, any directions given after the transfer has occurred can only apply to those financial assets that have not already been realised by the Board. [*Schedule 1, Part 3, clause 8*]

9.41 Directions given by the responsible Ministers about the transferred assets may be revoked or varied. [*Schedule 1, Part 3, subclause 8(1), note*]

9.42 Subclause 8(2) provides examples of directions that Ministers might give in relation to transferred assets such as the requirement that the assets be held for a specified period before they are realised or that voting rights be exercised in a certain way by the Board. However, these examples in no way limit the scope of the directions the Ministers might give. Directions must, nevertheless, be consistent with the Act other than in relation to subsection 18(10) (which requires the Board to seek to maximise returns). [*Schedule 1, Part 3, subclauses 8(2), 8(3) and 8(6)*]

9.43 If a direction is given, the Board must comply with it [*Schedule 1, Part 3, subclause 8(7)*]. However, in the event of non-compliance by the Board, the validity of any transactions is not affected [*Schedule 1, Part 3, subclause 8(8)*]. The aim of this provision is to ensure third parties are not adversely affected by the Board's non-compliance.

9.44 Subsection 17(4) allows assets transferred to the Fund to be realised, however, this is overridden if the responsible Ministers give a written direction that assets are not to be realised for a specified period. [*Schedule 1, Part 3, subclause 8(4)*]

9.45 Subclause 8(9) confirms that the responsible Ministers' power to issue directions about transferred financial assets does not limit the scope of directions that can be issued as part of the investment mandate under section 18. [*Schedule 1, Part 3, subclause 8(9)*].

9.46 Any directions given by the responsible Ministers must be published on the Internet by the Chair as soon as practicable after they are given to ensure appropriate transparency and accountability. [*Schedule 1, Part 3, subclause 8(10)*]

9.47 A Ministerial direction regarding transferred assets is not legislative in character and is therefore not a legislative instrument for the purpose of the LIA. [*Schedule 1, Part 3, subclause 8(11)*]

Continuing effect of instruments relating to transferred financial assets

9.48 Where a specified instrument relating to the transferred financial assets refers to the Commonwealth, the nominated Minister may declare (and thereby ensure) that any reference in that instrument to the Commonwealth is now a

reference to the Board [*Schedule 1, Part 3, subclauses 9(1) and 9(2)*]. Such a declaration is not legislative in character and is therefore not a legislative instrument for the purposes of the LIA [*Schedule 1, Part 3, subclause 9(3)*].

10

Schedule 2 — Debits of amounts from the Future Fund

Simplified outline

10.1 The simplified outline is intended to provide a high level introduction to the contents of this Schedule in order to aid readability. *[Schedule 2, Part 1, clause 1]*

Purposes of the Fund Account

10.2 It is important that the Fund is able to be drawn upon to relieve pressure on the budget at a time when the Government is facing spending pressures associated with an ageing population. The 2002 Intergenerational Report suggests that this time is likely to arise by 2020. Consequently, the Fund can be drawn on from the earlier of the point at which Fund assets are sufficient to offset the unfunded liabilities and 1 July 2020. For the purpose of discharging unfunded superannuation liabilities (that is, the unfunded portion of a superannuation benefit payment) the Fund can only be drawn down to discharge the amount payable in a particular financial year. *[Schedule 2, paragraphs 2(a) and 2(b)]*

10.3 This means that in a financial year where unfunded superannuation liabilities are able to be discharged from the Fund, the Government will have the flexibility of deciding whether to discharge the unfunded liabilities from the Fund; rely on the special appropriations which exist in the legislation governing the various superannuation schemes (in which case payments will be made out of the budget); or some combination of both. Such decisions will be a matter for the Government of the day and will not require a formal instrument to be made by the responsible Ministers. *[Schedule 2, paragraph 2(b)]*

10.4 To determine if unfunded superannuation liabilities can be discharged from the Fund in a particular financial year prior to 2020, a comparison is made between the balance of the Fund at the start of the financial year and the target asset level that is included in the target asset level declaration in force for that financial year. If the balance of the Fund is equal to, or in excess of, the target asset level, payments of unfunded liabilities can be made from the Fund to the extent of those that are payable during that financial year.

10.5 The following example illustrates the process for determining if payments of unfunded superannuation liabilities can be made from the Fund in a particular financial year prior to 2020.

Example 4

The balance of the Fund as at 1 July 2016 is \$132 billion.

The target asset level declaration that is in force for the period 1 July 2016 to 30 June 2017 specifies a target asset level of \$125 billion.

In this example, the Fund Account can be drawn upon to meet, either in full or part, the unfunded superannuation liabilities payable during the 2016-2017 financial year. If the government determines that \$5 billion out of the estimated \$7 billion in unfunded superannuation liabilities payable in the 2016-17 financial year is to be paid out of the Fund, the remaining \$2 billion is paid from existing superannuation special appropriations.

10.6 Once the financial year commencing 1 July 2020 is reached there is no requirement to measure the position of the Fund against the target asset level to determine if unfunded superannuation liabilities can be paid from the Fund.

- There is considerable uncertainty around contributions to the Fund, the Fund's investment performance and movements in the unfunded liabilities. It could be the case that at 2020 the assets of the Fund are insufficient to offset the unfunded liabilities but are nonetheless very substantial.
- Allowing the Fund to be drawn upon from 1 July 2020, without reference to the target asset level, ensures the Fund can be used to relieve pressure on the budget at a time when the Government has identified that it will be facing spending pressures associated with an aging population.

10.7 In addition to providing for the discharge of unfunded superannuation liabilities, clause 2 also provides for the payment of various expenses associated with the investment and administration of the Fund from the Fund Account. These expenses include:

- remuneration and allowances of Board members;

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- expenses incurred by the Board under a contract with investment managers;
- costs relating to investments of the Fund;
- costs of, or incidental to, the acquisition of financial assets and derivatives (including, for example, brokerage charges);
- costs associated with the establishment, operation or maintenance of a Fund bank account;
- costs associated with the Board entering into a contract of insurance (including in relation to individual Board members);
- the total remuneration payable to staff of the Agency;
- costs of engaging consultants and advisers (for either the Board or Agency);
- costs relating to the establishment and operation of the Agency; and
- costs of discharging any other expenses or liabilities incurred by the Board.

10.8 Paragraph 2(j) allows for the Fund to be used to discharge any other expenses or liabilities incurred by the Board. The intention of this subsection is to capture miscellaneous costs that might arise and which are not covered by the other existing purposes.

- For example, if the Board borrowed on a short-term basis in accordance with subsection 23(2), there may be related interest costs that would need to be met from the Fund. Similarly, if the Board acquired partly paid shares and a call was made for the shares to be fully paid, this amount would be paid from the Fund under paragraph 2(j). However, the application of this subsection is not intended to be used widely to meet expenses from the Fund and will be naturally constrained by the Board's powers under section 36.

10.9 The effect of section 12 is to quarantine the Fund, the balance of the Special Account and other investments, for the ultimate purpose of paying unfunded superannuation liabilities.

Board must ensure that there is sufficient money to cover the main purposes of the Fund Account

10.10 Clause 3 requires the Board to take reasonable steps to ensure that, during a year in which unfunded superannuation liabilities are being paid from the Fund, there are sufficient funds in the Fund Account to facilitate the unfunded liability payments. The Board may therefore need to liquidate non-cash assets from time to time to meet this obligation. [*Schedule 2, clause 3*]

Schedule 3 — Target asset level declarations

Simplified outline

11.1 The simplified outline is intended to provide a high level introduction to the contents of this Schedule in order to aid readability. [*Schedule 3, clause 1*]

Designated actuary

11.2 The designated actuary is specified through a determination by the nominated Minister. It is envisaged that appropriate procurement processes will be used to select the designated actuary. [*Schedule 3, subclause 2(1)*]

11.3 The determination specifying the designated actuary is administrative in character and is therefore not a legislative instrument for the purposes of the LIA [*Schedule 3, subclause 2(2)*]. The determination can be revoked or varied [*Schedule 3, subclause 2(1), note*].

11.4 The determination must be published on the Internet by the Chair of the Board as soon as practicable after the designated actuary has been confirmed by the nominated Minister. [*Schedule 3, subclause 2(3)*]

Target asset level declarations

11.5 Decisions of the Government in respect of transfers of amounts and assets to the Fund are to be informed by a calculation of the Fund's position at the relevant point in time and its comparison against the amount specified in the target asset level declaration for the relevant financial year. Examples of the calculations relevant to the transfer of amounts and assets to the Fund are provided in examples 2 and 3 of this Explanatory Memorandum.

11.6 Decisions regarding the timing of payment of unfunded superannuation liabilities from the Fund (before 2020) are informed by a comparison of the balance of the Fund at the start of a financial year with the target asset level for that same financial year as set out in the target asset level declaration. Where the balance of the Fund at the start of a financial year is greater than the target asset level for the same financial year, unfunded superannuation liabilities can be paid from the Fund. Payments of unfunded superannuation benefits from the Fund from 1 July 2020 do not need to take account of the target asset level. This is explained further in the section on Schedule 2.

11.7 The designated actuary may provide a written target asset level declaration to the responsible Ministers [*Schedule 3, subclauses 3(1) and 3(2)*]. The declaration is administrative in character and is therefore not a legislative instrument for the purposes of the LIA [*Schedule 3, subclause 3(9)*].

11.8 The nominated Minister must cause the declaration to be published, along with the reasons supporting the target asset level, on the Internet as soon as practicable. [*Schedule 3, subclause 3(10)*]

11.9 The target asset level declaration document may cover target asset level declarations for one or more financial years. A target asset level declaration may be given prior to the commencement of a financial year or during the year. It may be revoked by the designated actuary but not varied. When it ceases to be in force this does not affect the transactions performed using the target asset level declaration before it ceased to be in force. [*Schedule 3, subclauses 3(3), 3(4), 3(8) and 3(11)*]

11.10 A target asset level declaration for a financial year has effect until the end of that financial year is reached, a specified event occurs or the declaration is revoked. If the declaration ceases on the occurrence of a specified event, it is incumbent on the designated actuary to specify the event that causes the target asset level declaration to end. [*Schedule 3, subclause 3(6)*]

11.11 The first target asset level declaration is to be provided as soon as practicable after this clause commences. [*Schedule 3, paragraph 3(7)(a)*]

11.12 Only one target asset level declaration for a single financial year can be in force at any one point in time. If the target asset level declaration for a financial year ceases to be in force (for example, due to the occurrence of a specified event) the designated actuary is to provide another target asset level declaration as soon as practicable. [*Schedule 3, paragraphs 3(7)(b) and 3(7)(c)*]

11.13 The amount specified in a target asset level declaration for a particular financial year is not an amount that exactly matches the estimates of the Government's projected unfunded superannuation liabilities at the same point in time. Rather, the target asset level represents the designated actuary's 'best

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estimate' of the Fund account balance that would be expected to offset the projected unfunded liabilities accrued up to the same point in time based on the assumptions adopted by the designated actuary. *[Schedule 3, subclause 3(5)]*

11.14 Depending on the assumptions made by the designated actuary in setting the target asset level, it may be an amount that is higher or lower than the published present value of projected unfunded liabilities at the same point in time.

11.15 To ensure appropriate accountability, the designated actuary must provide a written statement (which is subsequently published on the Internet) setting out his or her reasons for specifying an amount as the target asset level for a financial year. The requirement to publish the statement ensures that is available for public scrutiny. *[Schedule 3, paragraph 3(1)(b)]*

11.16 A target asset level declaration document may specify different target assets level declarations for different financial years up to a maximum of five target asset level declarations. *[Schedule 3, paragraph 3(7)(d)]*

Example 5:

On 12 July 2006, ABC Actuaries provided written target asset level declarations covering the period 12 July 2006 to 30 June 2011. The document included the following target asset level declarations:

12 July 2006 to 30 June 2007:	\$90 billion
1 July 2007 to 30 June 2008:	\$93 billion
1 July 2008 to 30 June 2009:	\$97 billion
1 July 2009 to 30 June 2010:	\$100 billion
1 July 2010 to 30 June 2011:	\$103 billion

ABC Actuaries did not specify an event that would cause the declarations to cease therefore the declarations apply until 30 June 2011 unless revoked by the designated actuary before that date.

Reliance on projections when making target asset level declarations etc

11.17 Clause 4 specifies that in making a target asset level declaration the designated actuary can rely on the work of other actuaries but may also make assumptions and estimates as they consider reasonable and take into account other matters they consider relevant.

- The intention of this section is to allow the designated actuary to use assumptions and estimates provided by the actuaries of the various Commonwealth superannuation schemes, as he or she considers appropriate, but to also provide scope for his or her intellectual input into the establishment of an appropriate target asset level.
- It is possible that the designated actuary may request the actuaries responsible for establishing the projections of the unfunded liabilities of the relevant superannuation schemes to undertake modelling, using alternative assumptions, to assist the designated actuary to establish the target asset level.
- Any cost associated with such work would be a cost paid directly by the designated actuary to the actuaries responsible for the relevant superannuation schemes.