



LEGISLATIVE ASSEMBLY FOR THE AUSTRALIAN CAPITAL TERRITORY

STANDING COMMITTEE ON PUBLIC ACCOUNTS

(Reference: [Financial Management \(Ethical Investment\) Legislation Amendment Bill 2010](#))

Members:

**MR B SMYTH (The Inquiry Chair)
MS C LE COUTEUR (The Chair)
MR J HARGREAVES**

TRANSCRIPT OF EVIDENCE

CANBERRA

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**Secretary to the committee:
Dr A Cullen (Ph: 6205 0142)**

By authority of the Legislative Assembly for the Australian Capital Territory

Submissions, answers to questions on notice and other documents, including requests for clarification of the transcript of evidence, relevant to this inquiry that have been authorised for publication by the committee may be obtained from the Legislative Assembly website.

WITNESSES

BARR, MR ANDREW , Deputy Chief Minister, Treasurer, Minister for Economic Development, Minister for Education and Training and Minister for Sport, Tourism and Recreation.....	41
BROUGHTON, MR ROGER , Executive Director, Investment and Economics Division, Treasury Directorate.....	41
McAULIFFE, MR PATRICK , Director, Investment Branch, Investment and Economics Division, Treasury Directorate.....	41
O'HALLORAN, MS LOUISE , Executive Director, Responsible Investment Association Australasia.....	66
SMITHIES, MS MEGAN , Under Treasurer, Treasury Directorate.....	41

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Amended 21 January 2009

The committee met at 10 am.

BARR, MR ANDREW, Deputy Chief Minister, Treasurer, Minister for Economic Development, Minister for Education and Training and Minister for Sport, Tourism and Recreation

SMITHIES, MS MEGAN, Under Treasurer, Treasury Directorate

McAULIFFE, MR PATRICK, Director, Investment Branch, Investment and Economics Division, Treasury Directorate

BROUGHTON, MR ROGER, Executive Director, Investment and Economics Division, Treasury Directorate

THE INQUIRY CHAIR (Mr Smyth): Good morning all, and welcome to this inquiry by the Standing Committee on Public Accounts into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill.

I need to note for information that the committee made a statement to the Assembly on 28 October setting out how we are going to progress this. In that vein, that is why I am the chair. On behalf of the committee, I would like to welcome you, Treasurer, and officials from your directorate, visiting members and all others who are interested in this committee. In front of you, you have a privilege card. Have you read the privilege card and do you understand its implications?

Mr Barr: Yes.

THE INQUIRY CHAIR: Thank you very much. Treasurer, would you like to make an opening statement? Is this your first public function?

Mr Barr: It may well be, but as inviting as that opportunity is, Mr Chair, I am happy to move straight to questions.

THE INQUIRY CHAIR: All right. On page 6 of the government's submission, you make three recommendations. What has led you to make those conclusions and those recommendations?

Mr Barr: The facts before the government.

THE INQUIRY CHAIR: It is going to be very terse, is it?

MS LE COUTEUR: Did you wish to elaborate on that, Mr Barr?

Mr Barr: It is there in the government's submission. It is there in detail.

THE INQUIRY CHAIR: Why doesn't the government support the exposure draft?

Mr Barr: I think the legislation is impractical. It will be very difficult for officers within the directorate to comply with the legislation. I personally do not agree with many elements of the legislation, and that was obviously a view shared by my predecessor in putting forward this government submission.

THE INQUIRY CHAIR: In what ways is it impractical?

Mr Barr: As I understand it, chair, there are numerous difficulties associated with the arms-length elements of management of our investments. The issues associated with the draft list, as presented in the exposure draft, and thresholds in relation to what level of interest or activity a particular company may have in those areas that are identified, would at times be difficult to ascertain. There are obvious philosophical questions in relation to the purpose of the government's investments in this area. My view is that our investments are here to fund our superannuation requirements and to seek to ensure that we achieve the targets that we have set in fully funding those obligations, and that this is a political distraction from that.

MS LE COUTEUR: Right; that is pretty clear. Going to one point, you talked about the difficulties of evaluating whether things were in or out. I particularly noticed that in the submission. You said the problem was that, as the legislation was drafted by default, nothing was investable in; everything had to be evaluated to see that it did not have more than five per cent of anything excluded. Do you think it would be practicable if the drafting was changed so that the default position was that everything was investable in and it could then be demonstrated that something could not be invested in, so to reverse the onus—

Mr Barr: The question of the negative screening?

MS LE COUTEUR: I was still talking here about negative screening. Obviously I support positive screening, and that does not have the problems that you are talking about. But your submission—

Mr Barr: My understanding is that that still presents practical difficulties.

MS LE COUTEUR: Like what?

Mr Barr: I am happy for the officials to go into some detail in relation to that, but there are a number of challenges associated with it. There are philosophical questions that we have in the first instance, that obviously we will agree to disagree on.

MS LE COUTEUR: But this is not a philosophical question—

Mr Barr: Well, it is a philosophical question. I am happy for the Under Treasurer to provide some details in relation to the practical difficulties.

MS LE COUTEUR: Page 22, the second paragraph from the bottom is what I am specifically referring to.

Ms Smithies: I will start, and if we need to go into a greater degree of detail I will hand over to either Pat McAuliffe or Roger Broughton. In this respect you have put in place two pieces of proposed legislation; one of those pieces of legislation is really around how we handle our investments and what we cannot invest in. Your second piece of legislation is really around a positive requirement on us to invest in certain things.

Dealing with the first issue for us, the government has set in place a number of

strategic parameters around how we invest all of our investments. The most significant part of that is obviously our superannuation investment. We have a number of administrative factors in terms of how we do that. We have spoken before around our strategic asset allocation, and that is around trying to receive our 7½ per cent return to fund our outstanding liabilities. Therefore we have put in place a portfolio that balances risk, diversity and issues of liquidity. It does all of that. I will get to—

MS LE COUTEUR: Yes, because this is not answering the question.

Ms Smithies: So we have put in place a lot of structures around how we manage our superannuation. Essentially, what we would need to do in order to actually implement your legislation is that we would have to have long discussions around values/ethics/morals in relation to what could be invested in or should be invested in. And there are a number of technical things that you are putting in there around managing to limits of five per cent revenue. Those figures are not available in a prospective manner, so it would be difficult for us to actually hit the five per cent target.

The concern would be that, if we cannot guarantee that we can maintain the five per cent, or if we cannot guarantee that we are hitting the prescribed issues of what we should not be investing in, we would have significant concern around our ability to manage the legislation and be in breach of the legislation.

I think it comes out in the government's submission: there is a possibility for us to negatively screen, and that goes back to how we structure our portfolio and how we balance the portfolio between actively managed and passively managed. And that then comes back to an issue of administrative efficiency and effectiveness in relation to our return—so going back to those issues of administration and how we structure. So it is possible for us, in parts of particularly our active managed portfolio, to negatively screen for certain things. The government mentioned that as part of their submission.

For us to get to a point where we can negatively screen, obviously we would need to take direction in relation to what those things ought to be, what the thresholds are around those things and where we are concerned about it. I am sure we have discussed this before with tobacco products. Is it an issue with those who manufacture tobacco products or is it an issue with those who distribute, part of the supply chain, or is it with those who sell? Where do we draw a line in those sorts of issues? And then we would have to come back and take a look at companies who have significantly diversified interests—some of these multinationals—to have a look at their revenues and then try and figure out whether it is their total revenue, whether it is revenue gained from a particular activity et cetera, and then project what is not publicly available—prospective revenue targets. It becomes exceedingly difficult to administer, with a degree of certainty that we could guarantee for the government, so that we were not breaking the legislation.

MS LE COUTEUR: You are aware, Ms Smithies, that there are a number of organisations who make a living out of providing exactly that information, one of whom, I believe, does work for the ACT government?

Ms Smithies: Yes, I am.

MS LE COUTEUR: And you do not think they are accurate? You are suggesting it is not possible?

Ms Smithies: We are talking about two slightly different things. Could we negatively screen a handful of targeted companies from our active portfolio? Yes, we could. There are a number of—not difficulties, but we would need to take direction in terms of what would be the principles on which we would take that negative screen. So that could be done. But that is not what is outlined in your legislation. Your legislation suggests something significantly different.

THE INQUIRY CHAIR: It is not Ms Le Couteur’s legislation; it is legislation that is being referred to—

Ms Smithies: Sorry; that is not what is outlined in the proposed legislation. So that is right; we could negatively screen for some.

Mr Barr: What would they be?

THE INQUIRY CHAIR: If you go to the paragraph at the bottom of page 22, there are a couple of jumps there:

In the absence of such satisfaction an investment is a prohibited investment. In effect, this means all investments are prohibited unless—

somebody—

is satisfied ... the default position is that an investment ... is prohibited.

Given that there are tools, if you want to use the tobacco example, I think we would all be certain that Philip Morris derives the majority of its income from tobacco products. But can you invest in Woolies? How do you work out whether or not Woolies is at the five per cent threshold? So would you use other firms then, given that I assume our portfolio has Woolworths shares in it at some place?

Ms Smithies: I will hand over to Pat.

THE INQUIRY CHAIR: In a practical sense, how would you go about it?

Mr McAuliffe: How would we go about evaluating every company? Obviously we would have to go and buy that research from specialists to do that. In the conversations that we have had with a range of our current investment managers, what they are telling us is, “At the highest levels you can do some of this.” I guess the risk is in trying to be too prescriptive in a legislative sense, but at a broader level, these things are done.

The key difficulty that we have been informed about is the availability of information to make these assessments. There are many firms out there that do not actually publish every revenue line and those things so that you could actually drill down to that level of detail to make that decision. That is probably one of the biggest concerns—actually

how you get that information.

THE INQUIRY CHAIR: How much does it cost to get that sort of company search done?

Mr McAuliffe: I am not sure. We have not gone to purchase that advice. But it would not be cheap.

MS HUNTER: So we do not have an amount?

MS LE COUTEUR: We can probably find an amount. If the ACT Treasury is not capable of doing that research, I suspect we probably could. My understanding is that the ACT Treasury does not invest significantly in unlisted, very small or even outside the ASX top 200 in Australia. There is commercially available research for all of those companies, and the same goes for international companies—EIRIS does them. I am sure there are many others that do internationals. So I think that that information is available.

Mr McAuliffe: Certainly, we use EIRIS. We subscribe to EIRIS and we get all of their research. And that research provides a range of information about EIRIS. There are criteria in there that assess risks against ESG-type issues and things like that. But I do not believe that the information we get on all of those companies actually goes to the level of detail required to make decisions about revenue lines. I can check that, but that is certainly—

MS LE COUTEUR: Can I invite you to have a look at that, because certainly in the past EIRIS has provided that. I am speaking as someone who, in my distant past, has provided information for them, and they do provide that sort of information.

Mr McAuliffe: Perhaps it is a little bit of a generalisation too, but what we are saying is that, for a number of companies, you certainly can. But equally there are a number of companies for which you cannot find all of this information.

MS LE COUTEUR: That statement is true, about the companies where you cannot find information, but the question I am asking is: are those the sorts of companies that there is any possibility the ACT government would be investing in? I think the answer is that the ACT government, to my knowledge, tends to invest in larger companies, in ASX top 200 type things, rather than various—

Mr McAuliffe: We have investments right across the ASX 300. We are into the small caps companies in Australia.

MS LE COUTEUR: I do not think you have a lot—and the small caps ones, presumably your investment managers will have looked at with at least enough knowledge to know what their lines of business are. I am not sure that there really is going to be this information gap.

Ms Smithies: Could I ask for a little bit of clarification? Are we talking about negatively vetting for one or two particular activities or negatively vetting for the whole list of activities that are in the proposed legislation?

MS LE COUTEUR: Negatively vetting for the whole lot; it is not a large list. As Mr Smyth pointed out, for many companies, the amount of time to do the vetting would be very small, because they are in a known line of business.

Ms Smithies: I think it would be relatively clear, certainly around tobacco and armaments. I am not so convinced that it is relatively clear around the list that is in the legislation. In this space, with resources and time, you are right: we could go through all of this list and have a good look at the activities that companies undertake and the percentage of income they derive from particular activities. It would take time. It would take the bringing in of experts in this area. It is a long list and I think some of these are complex.

THE INQUIRY CHAIR: Against the list, how many companies would the ACT government be currently investing in?

Mr McAuliffe: We are investing in basically the Australian market, so the ASX 300, and internationally we are investing against the MSCI world index. There are about 1,600 companies in that index.

THE INQUIRY CHAIR: So to vet approximately 2,000 companies against the criteria listed, have you done an estimate as to what that would cost? Indeed, how much do you actually—

Mr Barr: It would not be a once-off exercise.

THE INQUIRY CHAIR: That is right. How much do you currently spend? You get information from Regnan and advice from EIRIS. How much are we currently spending on getting that information to guide our investment decisions?

Mr McAuliffe: The service that Regnan provides, which is the engagement service which they spoke to the committee about the other day, is about \$50,000 a year, and the EIRIS database that they provide to us is about the same amount.

THE INQUIRY CHAIR: Did you do any calculations on how much it would cost to vet every company in the list?

Mr McAuliffe: Regnan do not provide, if you like, a vetting service on companies like that.

THE INQUIRY CHAIR: But if you had to, if the legislation was passed and there are something like 2,000 companies in the two lists—

Mr McAuliffe: No, we have not done that exercise. As part of this process, we have actually asked our incumbent funds managers to what extent they believe that they could invest a portfolio for us that fully complied with this legislation. They have told us that they would find it almost impossible to do that, because they would find difficulty in being able to drill down to the level of detail to get the information they need to decide whether, for example, five per cent or more of a company's revenue is involved in some of these activities. Certainly, they can probably do it for some

companies. I guess the issue is all companies, to comply with the full list.

MS LE COUTEUR: And you have not looked at the other alternative of providing for your investment managers the information from EIRIS, CAER and other companies in this space?

Mr McAuliffe: Many of our investment managers actually use some of this research.

MS LE COUTEUR: So those managers would be able to do it. None of these things here are things which are unique to this bill. They are things which other organisations and entities have decided they want to prohibit; screens for these are commercially available.

Mr Barr: Some have added Israel to that list—any product out of Israel to that list.

MS LE COUTEUR: We have not got that in here.

Mr Barr: No, it is not in this one but other organisations have sought to do that.

MS LE COUTEUR: Yes, absolutely. This is not a very extensive list of things to exclude. There are many organisations that would have a much more extensive list than this. This is a fairly pared down list.

Ms Smithies: One of the comments I would make on that is that those organisations do not have a legislative requirement that hangs over them around being able to prove particular things or disprove particular things. That is a significant concern in administering a piece of legislation.

MS LE COUTEUR: It gets back to my original question, when you suggested that how it was written was making it difficult, as well as the actual concept. It seems to me that what you are saying at the bottom of page 22 is about potentially some small changes in the drafting. I agree that you have issues philosophically, but there is probably no real percentage in discussing that in this hearing. My question about the bottom of page 22 was whether you were saying some small changes in the drafting could make what I agree is still not what you want to do but something that would be still undesirable but possible. That is what I am trying to get at with this.

Mr Barr: Yes, if you dropped five per cent to a number significantly less and removed everything in (b)(i), (ii), (iii), (iv), (v), (xi), (xii), all the way through to (xiv), you would get something more workable. But I think that would entirely defeat the intent of what is proposed. I am referring to new section 38A on page 3 of the exposure draft.

MS LE COUTEUR: When I talked about page 22, I was thinking about the government submission—

Mr Barr: Your question was—

MS LE COUTEUR: which does refer to a—

Mr Barr: Your question was: what changes could you make to the legislation? I thought that was the question.

MS LE COUTEUR: Yes.

Mr Barr: I am saying that if you were to set a threshold lower than five per cent and remove your list or significantly reduce your list, it would make the legislation more workable potentially.

THE INQUIRY CHAIR: Would you make a lower threshold or a higher threshold?

MS LE COUTEUR: I think he possibly meant higher.

THE INQUIRY CHAIR: If you make it lower, it is even harder to—

MS HUNTER: Yes, lower might be harder.

Mr McAuliffe: The advice that our managers have given—

Mr Barr: A screening threshold, yes.

Mr McAuliffe: The advice that our managers have given us is that, given five per cent is such a difficult number to try to come to grips with, if you come to the decision that they are involved in that activity at all, the safest thing is just to simply not invest in them.

The other advice that they gave us is that, from their own reading of the legislation that is proposed, and given the difficulties of finding some of the information, they have estimated that up to potentially half of the ASX 300 would be screened, and at least a third to up to a half of the MSCI world index. That is the advice that we have been given, based on specialist managers that invest in the market, if we gave them the mandate to implement this for us.

Ms Smithies: So there is a practical issue there for us in terms of our direct investments versus our passive investments. And if we cannot invest in the index, or if we are excluding a significant number of companies from the index, how then do we deal with the passive side of our investment rather than—

MS HUNTER: I want to pick up on that, because we have actually done some work and put it through screening, and what has come out of that against the ASX 200 was that no more than 60 companies would be screened out, using what is currently in the bill. In fact, it is about 62 but there are two that come up twice. As you said, you predicted it was going to be half; from our work it is about a third. It is more around that argument of a concentrated portfolio. You talk about concentrated risk and so forth. Can you just elaborate on that a little bit?

Ms Smithies: Yes. Again, it comes back to the structure of how we have done our whole strategic asset allocation. The theory is that you need to diversify your risk, and for a market to have reasonable shareholdings in enough of the market so that when one part of the market is going poorly, it is buoyed off against the other part. Having a

look at the performance of the mineral intensive markets over the last three years is actually useful in this. The indexes have shown a clear reduction in return on mining exposed or mining-related companies.

MS HUNTER: As you say, it is important to diversify. You need to ensure that you are not caught with some intensification in one area so that your returns are going to drop. But haven't you just said that, having looked through it, having asked your people to have a look, 50 per cent would be screened out? Isn't that telling us that you in fact have got it too concentrated in certain areas? Maybe you are not really looking at a diversified portfolio as much as maybe you should? In particular, as you are saying, the world is changing—areas might have had larger returns a few years ago.

Ms Smithies: I would actually put it the other way: with 50 per cent screened out on such a large list here, we actually do have a diversified portfolio. We have a very diversified portfolio.

MS HUNTER: You mentioned active and passive parts of the portfolio. What has been the experience around the returns on the active part of the portfolio versus the passive part of the portfolio? Is that giving us some information about whether we should be shifting one way or the other?

Mr McAuliffe: Our starting point is to invest in the market. We do that through an index arrangement. It is a cheap and efficient way—a low-cost and efficient way—of getting access to the market. We then introduce active management. The active management is not driven by return-seeking goals—that they are going to actually try and drive to outperform that market return. It is more as a risk tool, to try to more actively manage part of the market, particularly in terms of downturns in markets.

A good example of that is that, in the current environment, just in the lead-up to the end of the financial year, the markets all went into shock waves because of Europe and everything. I think one of our managers, our active manager in Australian equities, Perpetual, did very well for us. Their performance outperformed that market because of their style and the way they manage in that type of market style. So the active managers are there; that is our starting point, as a risk tool.

With international equities, the active management experience has not been the greatest over time. In fact, international equities themselves have struggled over the years. So if we were having a look at where things are going now, we would probably have a tendency to head more towards the index-passive management for our international equities portfolio, and then perhaps look to introduce some more specific-type strategies.

So in answer to your question, the index has performed as we would expect an index to perform. Again, it gives us a low-cost, efficient investment structure.

THE INQUIRY CHAIR: On the bottom of page 24, section 5.7, “Relevant body”, you make the observation that you believe this law would only apply to the Australian share market. You say that it “would not be applicable to international share investments”. How do you come to that conclusion?

Mr McAuliffe: In the draft legislation, it actually has the definition of a relevant body, which is linked to the investment, as a company registered under the Corporations Act, or a body under the Corporations Act. To us, that is clearly just Australian companies. I think it is a drafting issue.

THE INQUIRY CHAIR: With your interpretation of that, would that make it impossible for you to invest in overseas stocks or does it in fact go the other way?

Mr McAuliffe: I just do not think the legislation would apply to overseas stock in that.

THE INQUIRY CHAIR: Therefore you would have open slather on the international but be locked out of the Australian market. The paragraph above paragraph 5.7 says:

As there is no universal agreement as to what constitutes an ethical investment ...

What is the current understanding of the government of what “ethical investment” is?

Mr Barr: There are many different views.

Mr McAuliffe: I am not sure. I do not know that there is an agreed definition. It depends who you ask.

THE INQUIRY CHAIR: How would you define your current investment policy in terms of ethics?

Mr McAuliffe: Given the announcement that the government has made and the policies the government has in place, the more appropriate language is probably a responsible investment policy, as opposed to ethical, which again everybody has different views on.

Ms Smithies: I think we have been through a lot of this. The framework that has been approved by the government is around value-based investment—sorry, risk-based, which does look at the issues of social, environmental and sustainable. But it shies away from the issues of ethics—and, indeed, whether we are talking about ethics or morals here. I think it is an awkward part of investment policy and government policy in relation to actually putting a boundary around what constitutes ethics or morals et cetera, or even values, in this sense.

Obviously as a Treasury, we are guided by the strategy that is put in place by a government on this issue. The work that is done in this field really comes back to some of the issues of corporate governance and sustainability, both from a financial and from an environmental sense, and what we glean through what our research is telling us around those companies.

It is a really good question: what is ethical investment? It is a really great question. The guys have done a bit of research on this, and we are having a lot of difficulty in finding a commonly understood definition. Even if we had that, we would obviously be looking to the government—

Mr Barr: To test that against certain behaviours. To be very blunt, there is not even an agreement within the political party that has proposed this in relation to what constitutes ethical investment. We have seen this play out in Marrickville in recent times, and on a national stage between the party leader and a new senator from New South Wales. So to suggest that there is going to be that agreement here, or in fact even in expending resources and valuable time in seeking to find the answer to that question, is questionable. In my view, funding our superannuation obligations should in fact be the priority in this instance.

THE INQUIRY CHAIR: In section 5.6, where you talk about investing in pooled trusts, what will the bill, if it got up, do to your ability to invest in pooled trusts?

Mr McAuliffe: Our interpretation, when you read the explanatory statement, is that the prohibitions would apply to both indirect and direct holdings. Through our pooled trusts, we do not directly own an individual company. We buy units in the market. If the intent is that because we are deriving a return from the exposure to all the underlying companies in that market then we could no longer do that, we would have to undo our index investment arrangements so that we could only directly invest in companies where we could apply the legislation.

THE INQUIRY CHAIR: So what would that do to the cost of running your investments?

Mr McAuliffe: At the highest level, the cost for us to invest in pooled funds averages about six basis points, if you want to average domestic and international. With Australian active equity managers, their fees are in the order of 40 basis points per annum and international are up around 60 basis points. So when we have such a significant allocation to index, and if we had to convert those into direct holdings and effectively have them actively managed, we increase the cost by the difference.

The other question which the legislation is silent on is: what will we do with our fixed income investments? You could assume that if you are going to exclude a company in terms of our equity investment—let us take BHP as an example—then we would not be able to buy their debt. So if you want to follow that through logically, we would have to undo all of our bonds that are all passively managed, both internationally and domestic. We would have to undo all of those so that we directly invested in those as well. So it is not just the equity part that we are talking about here.

We put some estimated numbers, at the extreme, in the submission—an annual increase in management costs of up to \$11 million per year. That is how we get to that number.

MS LE COUTEUR: I do not quite know where to start. I will start on a whole different subject, which is one that you have not dealt with particularly in your submission. It is one that I am bringing up for the purpose of having it on the record—that is, the status of the territory's obligations as far as the superannuation fund goes. My understanding is that the territory does not have a fiduciary obligation to the potential superannuants, that it is merely another piece of money that the government has to manage. The ACT government has an obligation to pay money to the commonwealth and it then goes on to the superannuants, but there is no direct

fiduciary relationship. Could you say whether you agree with that?

Ms Smithies: Yes.

MS LE COUTEUR: Or expand on it if I have got it wrong. It is something which is brought up frequently. I would like to have on the record Treasury's views.

Ms Smithies: That is correct. I draw the distinction that the government obviously has a duty to ensure that all of the liabilities that have been collected over the last 22 years or 21 years to its employees are paid.

MS LE COUTEUR: Yes.

Ms Smithies: So there is obviously that obligation, but the vehicle for that really is in relation to the government's relationship with the commonwealth super funds. And the relationship then is between the individual and the ComSuper funds et cetera.

Mr Barr: Of course there is an opportunity cost associated with—

MS LE COUTEUR: Yes, there is clearly an opportunity cost but there is no fiduciary relationship; it is merely, from an ACT government point of view, something for which, for obvious financial reasons, they want to get the best financial return. But it is not—

Mr Barr: Yes, so that we can fund a whole range of other worthy activities, Ms Le Couteur.

MS LE COUTEUR: Yes, but it is not a higher relationship than that; it is simply—

Ms Smithies: We do not run a superannuation fund; that is exactly right. And what we put in our investment is money that we have put aside to pay future and emerging superannuation payments to ARIA.

MS LE COUTEUR: I am probably being really dense here, but a couple of times you have said that the legislation as drafted does not exclude any international investments. You went through this really quickly. Can you just go through it again? I am feeling very thick on this.

MS HUNTER: This is the one that Mr Smyth raised before.

Mr Barr: Yes, it is in the definitions.

MS HUNTER: At the bottom of page 24.

Mr Barr: On page 5 of the exposure draft.

Mr McAuliffe: Basically it says that investment is prohibited if it includes investment in a relevant body. And in the definition of "relevant body" is companies—

MS LE COUTEUR: Sorry, I have got page 5. Are we on page—

Mr McAuliffe: I am actually looking at the legislation.

MS LE COUTEUR: Yes, I have got the legislation, page 5.

Mr McAuliffe: Yes, page 3.

MS LE COUTEUR: Okay, that is fine.

Mr McAuliffe: 38A(2).

MS LE COUTEUR: I am sorry, I am still not seeing the bit that says—

Mr Barr: Okay, so that refers to a relevant body and then on page 5, a relevant body is given a definition. That definition refers to—

MS LE COUTEUR: A relevant body—

Mr Barr: the meaning in the Corporations Act.

MS LE COUTEUR: So those relevant bodies are all Australian because of the Corporations Act, by definition?

Mr Barr: Yes.

MS LE COUTEUR: Okay, I see your point. It is clearly a drafting error in that it is not exactly what we were meaning.

Ms Smithies: We were simply pointing that out.

MS LE COUTEUR: It is a good point, yes.

Ms Smithies: I think what you see reflects the work that has been done to go through the draft legislation to see how we could or could not deal with that, the definitional issue and the implementation issue.

Mr McAuliffe: I have looked everywhere to see if there is any other legislation anywhere else that we could use as some sort of a precedent or something like that. Basically I cannot find any. The closest attempt to try and do something similar was last year in New Zealand, and that fell over at the end. If you look at the *Hansard* of the debates around it, a lot of it was around the definitional things and just the whole prescriptive nature of trying to do this sort of stuff in legislation. Most people adopt a broader policy position and then—

MS HUNTER: I believe that was a Labor bill supported by the Greens but defeated by the conservative government. We were talking before about the definition of ethical investment and the difficulty around that that you were talking about. In some ways I would put it that it is irrelevant because you have prescribed items in here, so it does not really matter—the debate may or may not be out there as to whether it is ethical investment, whether it is responsible investment or whether it is some other

title. It just brings back to the legislation that we actually have the issues prescribed here, and that is what the focus is.

Ms Smithies: Yes, I acknowledge that and I do not disagree with that at all. Again, for us, in administering that, there is obviously an issue regarding the legislation which sets our framework in relation to how we would invest.

Mr Barr: There are two issues, Ms Hunter. The first is whether you agree there should be anything in that list and the other is whether you would agree with what is in there. I would have a personal view on a number of the items that are in that list and would question why they are in the list. There are others I could see an argument for. That would be a personal view. And I would have a question as to whether my personal view should in fact be driving investment policy. That is another philosophical issue that obviously the Assembly would need to grapple with.

MS HUNTER: Which is why it was draft legislation sent to a committee for a discussion with the community, and that is what we are doing, which is a good process.

Mr Barr: Indeed, that is fine. I am putting a personal view and a political view. And the officials who would be required to implement such legislation have briefed me on the practical difficulties of the process.

MS LE COUTEUR: You have talked about the costs of change. I suspect that they may be overestimated; what amount of churn do you have anyway?

Mr McAuliffe: In terms of the costs, the starting point is that if we went down the path of doing some sort of extensive negative screening as opposed to just taking out a couple of sectors, it is possible that our incumbent managers may not be the best-placed managers to do that. So we might have to look towards more of those managers that class themselves as specialist ethical investors. We would have to move the portfolio across to them. They would not take the whole portfolio, so you would have to sell out the stocks that were not required. You could in-specie some holdings over, but at the highest level, every time investments are bought and sold, there are buy and sell spreads, and for equities that is about 30 basis points. So even going back to if we had to move out of our passive across to active, we would have to basically sell the whole passive equity portfolio to move it across. There is a 30 basis point charge just to do that. I do not think that churn would resolve an implementation of such a strategy.

MS LE COUTEUR: Have you looked at this in a more positive light, in that what is in the bill is a fairly pared down list of ethical investments? You may not agree with that, I suppose, but—

Mr Barr: I feel very sorry for the wine industry, who miss out there.

THE INQUIRY CHAIR: Yes, and the future of the whiskey industry.

Mr Barr: Yes, the whiskey industry as well. It is very puritanical, anti-liquor!

MS LE COUTEUR: It was put together by taking common elements from many different ethical screens, so a more positive way—

MS HUNTER: Recognising the massive harm that alcohol does at the moment, and we have seen that each day, but anyway, let us not get into the detail of what is particularly in here.

Mr Barr: I thought we were examining the bill but—

MS LE COUTEUR: I think there have actually been some ACT government campaigns which are against drinking alcohol.

Mr Barr: In excess, not in moderation.

MS HUNTER: In excess, indeed. I think that is the point.

Mr Barr: So we need to have that screening requirement then: companies that produce excessive alcohol—

MS LE COUTEUR: Where I was actually going was to a more positive way of looking at this. Given that what we have got, we think, is a reasonably pared down list of ethical criteria—and possibly it would be pared down even more—have you looked at saying, “Okay, we still want to do pooled investment,” and then going to one of your investment managers or another investment manager and saying, “We’ve got X million,” I am not quite sure what X would be precisely, “that we could have as the basis of a new fund,” whatever you wanted to call it. That potentially would be a very positive way of doing it and potentially very cost effective because you would have a pooled investment vehicle that was along the lines you were looking at.

Mr McAuliffe: I am not sure that I follow.

MS LE COUTEUR: Basically I am suggesting that the ACT government has quite a bit of money to invest. It has enough so that it could go to a range of investment managers and say: “These are the rules. Would you like to start up a fund along those lines?”

Mr McAuliffe: That invested in certain areas that—

MS LE COUTEUR: Yes, if the bill—

THE INQUIRY CHAIR: Set up a pool. I think what is being suggested is to set up a pooled fund that only has ethical objects in it that the ACT government—

Mr Barr: Right, so—

MS HUNTER: Or it targets particular investments.

Mr Barr: So if we make the theoretical leap that we could agree on what would be in such a pool—

MS LE COUTEUR: Yes, we are making that theoretical leap.

Mr Barr: would we consider doing that?

MS LE COUTEUR: Yes, as a—

Mr Barr: There are a series of hypotheticals there. I would not rule it out, but as long as it would fit within an overall diversified portfolio and guaranteed a return so that we were not disadvantaging. The opportunity costs associated with that would need to be negligible, I would have thought.

Mr McAuliffe: I do not think that you are actually achieving an index pooled fund by going down that path. You are actually moving right away from the concept of—

MS LE COUTEUR: I am not suggesting it would be an indexed pool. Obviously we are not talking index here.

Mr McAuliffe: No, we are effectively moving from that specifically to actively managed accounts. That is really what we are doing. I do not think it is—

MS LE COUTEUR: Yes, but it could still be in a pooled vehicle; that is really the point I am making.

Mr McAuliffe: We would not want to put all of our money with one manager like that, anyway, under that circumstance. You would want to have some diversification across different asset classes and the different strategies we would like to adopt.

THE INQUIRY CHAIR: Ms Hunter, a new question?

MS HUNTER: I understood there was some support for exclusion of tobacco and weapons, looking at clean technology allocation, and doing that sort of positive screen and appointing a new equity manager with responsible investment experience. That is what I had picked up was—

Mr Barr: I understand that is what the former Chief Minister and former Treasurer moved to, following a review in 2007. Is that history right?

Ms Smithies: Yes. Ms Hunter, I think what you are referring to is at the back of the government's submission where there are a number of future responsible investment considerations which—

MS HUNTER: And the ones I have just mentioned, yes.

Ms Smithies: Yes, that is exactly right. They are possible in this space and it does talk about a limited number of negative screens. They are exactly the ones that you discussed, yes. We have said that there are things that can be done in this space. The issue is how many, how far, under what administrative structure and under what legislative structure. Who decides, how do we get our direction and how is that all determined? There were probably some more obvious and easier ones that were put in the government's submission. In a way, it was the thought of the former Treasurer

that these were things that may well be considered by the committee. While we have done a bit of work on these and they are certainly all implementable and do-able, before any decision was made we would see how this process went. That would be right, wouldn't it, Pat?

Mr McAuliffe: Yes, that is right. And still keeping in mind the broader objectives that we have got. So if we talk about perhaps that higher level screen of what is suggested there, the tobacco sector and the armaments sector, if we wanted to focus on, say, cluster munitions, the easiest thing for us would be to do the armaments sector, if that is a decision that was taken. Those can be implemented fairly easily. You are talking globally, in total, about 30-odd companies. The issue that we would still need to tackle would be: knowing that we have still got index management in the background and that we would not be able to apply it to that unless we, again, had to restructure the index management to do that, you could easily do this where we direct investments in those particular sectors.

With the positive screen side of things, we have a private equity program. We put a couple of examples of some companies in there that are pretty good companies in that sort of space. We are looking to set up a third fund, moving forward. So when we do that, we can have a specific consideration that there is a greater emphasis on trying to source out those sorts of companies. With our current mandate, we ask our managers to look at and weigh up all the opportunities and take what is the best opportunity—and we get some that fall out. But they are the sorts of enhancements that we think we could do that are progressing the responsible investment policy, if you like.

MS HUNTER: In relation to that, two that are included in the bill relate to international labour standards, particularly around child labour. Why didn't you include it and are there particular issues around that? For instance, I know that with the Norwegian government's fund, they have made the decision to pull out of Wal-Mart because of very poor labour practices and workers not being looked after. Did you have a chance to look at that or were there some particular issues that meant that you did not include that as an example?

Mr McAuliffe: That has not been looked at specifically. These were a couple of ideas that the former Treasurer suggested as a starting point to talk about it. The Norwegian government's fund is quite interesting. They have that sort of active policy around there. The point I would make about that is that at the end of 2010, they had about 8½ thousand stocks under investment and their current screening is about 52. Of that, they have screened out the tobacco and armaments sector, which is about 30-odd of that 52.

Ms Smithies: Equivalent in our investment portfolio.

Mr McAuliffe: That is right.

THE INQUIRY CHAIR: Ms Le Couteur, a new question?

MS LE COUTEUR: I might go to a new subject, about voting. In your submission you have quoted on page 16 from the 2007 review of the application of ESG to the territory investment principles. Point 5 says:

ACT Treasury requires the Territory's fund managers to provide their voting policies, requests that they exercise their voting rights and report on their voting activities.

And as you say here:

... the ACT Chief Minister and Treasurer Jon Stanhope announced that the ACT Government had agreed with all of the recommendations of the report.

Last week, I think it was, Ms Hunter and the other Greens asked a series of questions on this, asking whether the government knew how it had voted on certain things, particularly regarding Woodside and a climate change motion. At that stage Ms Gallagher answered as Treasurer, and basically the answer was, "We don't know." So is the government in fact following that policy? It is on page 16 of your submission, if you would like to reread it.

Mr Barr: My understanding is to the best of its endeavours, yes.

Mr McAuliffe: We know what our managers' policies are and we know how they vote. We do not know how they are going to vote in advance but we know how they eventually vote.

MS LE COUTEUR: You do not direct them in any way; you are indifferent to how they vote?

Mr McAuliffe: No, we have delegated the voting decisions to our managers to exercise—

MS LE COUTEUR: Have you given them any guidance on this?

Mr McAuliffe: The way fund managers typically vote is that they are managing a pool of investments for a range of clients and, if they are given a delegation on how to vote, they form a voting position on the voting issue.

MS LE COUTEUR: So—

Mr McAuliffe: And they exercise that vote for all of the votes that they represent. They do not think, "Hang on, with 98 per cent of our votes we're going to support the motion and vote two per cent against the other way for a particular client." That is not the way the process works. If clients choose to have the opportunity to override that voting position, that would require the individual client to go through and do all the internal research and process to form a voting decision and then instruct the manager to override their vote—or, alternatively, do the direct voting themselves.

MS LE COUTEUR: Do you know how the vote on the ACT's behalf happened with Woodside and climate change?

Mr McAuliffe: One of our managers had some shares on our behalf in Woodside and they did not support the vote.

MS LE COUTEUR: Did you have any commentary? Did you discuss this at all? Did

you feel that was appropriate—that it is not one of the ACT government’s interests?

Mr McAuliffe: We do not instruct the manager how to cast the vote. I know the reasons why they did not support the vote—the reason that the vote was not successful, which was the general reason for the shareholders that did vote.

MS LE COUTEUR: Which was?

Mr McAuliffe: Basically, the view was that it was not in the company’s interests to provide sensitive financial assumptions around their assumptions. That was the broad reason.

MS LE COUTEUR: So you state here that we require our fund managers to provide their voting policies. We have a policy of not commenting in any way on the voting policies; is that really what you are saying? It is information only, we are not doing—

Mr McAuliffe: Well, the company’s voting policies are—

MS LE COUTEUR: No, I am quoting again from the report. It states:

ACT Treasury requires the Territory’s fund managers to provide their voting policies ...

Effectively what you are saying is that they have provided information only; there is no two-way dialogue. You are not seeking in any way to influence the votes?

Mr Barr: How many votes would there be?

Mr McAuliffe: Last year there were 5½ thousand voting items that our managers collectively voted on.

Mr Barr: 5½ thousand; okay.

MS HUNTER: Surely, minister, if there are issues that directly clash with ACT government policy, it would not take too much research to be able to quickly assess things? There is lots of work that goes through government all the time.

Mr Barr: I suppose it would depend on the amount of notice we had of particular votes.

MS HUNTER: How much notice is usually given on votes?

Mr McAuliffe: In the US, for a company’s AGM—and this goes back to that question about Delta the other day—the meeting announcement is usually put out about 30 days before the AGM. The actual meeting agenda does not necessarily come out on the same day; it may well come out a few days later. And it is not until the meeting agenda comes out that shareholders—I will say shareholders, whether you are doing it yourself or you get your manager to do it—are able to avail themselves of the detail of the resolution, the company board’s views on the particular resolution and, in most cases, they also seek independent proxy voting research from companies

like ISS, ACSI or CGI Glass Lewis. So there is really only a couple of weeks opportunity for them to consider their position and then put a vote in, and there are usually cut-off times that they have to lodge their votes by. So it is a pretty small window.

Ms Smithies: This is something that we have talked through within the administration. In a sense it comes down to, with 5,200 votes, you could argue that it would be a relatively quick process to actually pick up the ones that are of most fundamental concern to government policy. That may be true, but in that there may be things that we will then miss. So we are already setting up a process that would mean, by definition, out of, let us say, 5,000 votes, we probably are going to miss some.

Even if we get down to a point where, in those time frames, we are assessing the merits or otherwise of particular resolutions et cetera, of 100, 200 or 300, my concern in administering this comes down to the issue of the information available and the level of understanding about the particular issue. In my experience—and I am sure that you would appreciate when I say this—things are never black and white, and things are never polarised to one particular position. It is not often the case that you get issues that come forward that are of such clarity that they are clear and you can say, “Yep, get all of that,” and that, if I scratched below the surface, you would not get a number of other issues or complexities et cetera.

If we are going to go through that process and vote in the territory’s name, to me, as the chief executive administering this, it ought not be my view on this, it ought not be the view of the officials that have actually gone through the research and gone through the journey in terms of understanding what in many cases can be really complex issues behind workforce management, human rights or issues that have been put forward to boards and shareholders. We would then have to have the resources to go through and provide relatively good advice, and it would have to be advice to government, or a minister, in order for them to make a decision.

As a Treasury, we can advise and we can implement, but in these sorts of things, when it comes to exercising your right around a particular policy stance, which I guess is what we are talking about here, or the implementation or manifestation of a policy stance, I would find that an extraordinary position to be put into, in terms of our responsibility.

You could reasonably say, “Well, let’s change the process,” and obviously those things would go to the Treasurer, but there are obviously time frames involved in these matters. And while I do agree that some issues may well be very clear, I honestly think that in this field not everything is black and white. I think it is fair enough to put on the table issues of vexatious shareholder resolutions et cetera, things that have been brought out ostensibly for what would be significant areas of community concern or contradictory to government policy, but if you actually look further below them, they are not really what they have been dressed up to be. So I would feel obliged to have done a reasonable amount of research in providing the Treasurer with a recommendation in this space.

In that sense, it is no different from the process that Treasury would go through when you go through the development of policy advice and how you would take a position

on things, but this is an extraordinary space to get involved in, particularly when a lot of these things happen overseas in line with—

Mr Barr: Different political cultures?

Ms Smithies: Different political cultures, different social cultures and social make-ups. That probably expresses my concern about how we would go down this path.

MS LE COUTEUR: Does that mean that in practice what happens is that you vote with management?

Mr McAuliffe: Our managers do not vote with management in all cases. They will analyse all of the research that is put in front of them from their own internal research, from management's views on the particular resolution, as well as from the independent research that they purchase. They weigh that up and will vote accordingly.

THE INQUIRY CHAIR: Just to go back to dot point 5 on page 16, I assume you have got all the voting policies from all the funds managers that we use?

Mr McAuliffe: Yes.

THE INQUIRY CHAIR: Are there any there that were of concern to your area?

Mr McAuliffe: No. Most people have a similar style of approach in terms of their policies. Let me give you an example. They will take responsibility for voting their clients' proxies, they vote in the best interests of their clients, they are looking to maximise economic and shareholder value. So they consider all of those and they will consider, in terms of the particular issue, what the impact is on the actual company itself. There might be costs to implement it. If there is a significant reputational risk around the company then they will look to try to manage those things. They all generally follow a similar framework in that regard.

THE INQUIRY CHAIR: Have you ever received the voting policies of an organisation and disagreed with them? Or having seen the voting policies, has that caused you to withdraw from a fund?

Mr McAuliffe: No.

MS LE COUTEUR: Have you ever made any commentary to the managers about the voting policies?

Mr McAuliffe: We select our managers on a range of criteria and their voting policy is just one aspect of it. So we are comfortable with the voting policies of our current managers.

MS LE COUTEUR: So you are comfortable and you have made no commentary about any voting issues to the managers?

Mr McAuliffe: We have not sat back and reviewed how they have voted on an issue

and then gone back to them and said, “Gee, we really think you should’ve voted this particular way.” No, we have not, if that is what the question—

MS LE COUTEUR: I was actually hoping it was going to be a bit more proactive, but clearly no. I agree there are lots of things where it is unclear exactly what the ACT government’s views would be, but on some things the ACT government probably has some fairly clear views. Climate change is one that comes to mind. We have passed some fairly clear legislation which suggests at the very least we think CO₂ emissions should be going down, not up.

MS HUNTER: Another one would be child sex slavery. I cannot see that you would have these issues around different governments, different cultures and so forth. It is a pretty straightforward issue, so I am wondering—

Mr Barr: It would be interesting to see how many votes of that nature would appear across—

MS HUNTER: There are some that would not be so black and white. There would be some very clear ones.

Mr Barr: I cannot imagine it is a hot-button issue in terms of votes. I am happy to get that information from Treasury but—

THE INQUIRY CHAIR: One of the others that has been presented is the company Carnival, which owns P&O. It is dual-listed in London and New York. From this gentleman’s experience, it was suggested that we would at some point own shares in it. There were concerns that they were promoting tours to places where child exploitation was occurring. So the question is: how do you cope with a situation like that?

Mr McAuliffe: We do not own Carnival. I think that is the starting point.

THE INQUIRY CHAIR: We have no Carnival shares?

Mr McAuliffe: No.

THE INQUIRY CHAIR: There you go. That was easy.

MS HUNTER: A step forward.

THE INQUIRY CHAIR: In regard to the voting policy, you mentioned earlier about doing your research before you invest in a fund. How significant is their voting policy on shareholder resolutions when you determine whether to invest with somebody?

Mr McAuliffe: It is not a stand-alone criterion.

Mr Broughton: As Patrick said earlier, the voting policies are very similar right across the board. We have to understand—we discussed this earlier—the government fund does not have a fiduciary duty but our managers have a fiduciary duty to their investors, and they have to balance that against all these other criteria. So their voting

policies are along the lines of emphasising the fact that they have that fiduciary duty and they will carry that through.

The government's policy in relation to investments to date has been that we will be a signatory to the principles for responsible investment, and we will conduct ourselves accordingly. Part of that is that we want the voting policies to reflect the fact that for investment purposes we have a balance between the fiduciary duty and the long-term benefits to the companies that are involved in the investments, and that means taking into account not just financial returns but the impact for the companies of ESG criteria.

So that is our policy and that is the way we are implementing it. I think most of the managers we have got on board were put in place prior to us signing up to the PRI, but we have, since signing up, gone back to them and checked on their credentials in that regard. Certainly, at any point in the future when we change managers, it will be on the basis that that manager has adopted the principles for responsible investment.

Mr McAuliffe: Or at least they can demonstrate that they have appropriate processes and practices in place to deliver what we would like them to deliver. There are a number of managers around the world who are having difficulties in signing things like the PRI—not saying that they cannot comply but there are a whole range of issues that go with it.

MS HUNTER: What are those issues?

Mr McAuliffe: Some of them are internal issues; they might have a US-based manager and they have an operation in Australia, so the Australian operation might be keen to go down that path but they are still having difficulty in discussing that with the international manager. Some managers are still just not totally clear and they are still waiting to see how the whole PRI evolves over time. There is a question about compliance, and if they just blindly sign up for the sake of it, what does that mean in terms of how they have to all be measured in doing things? So it is more of a question still of looking into it. It is not a matter of saying that they do not want to because they do not believe in it; it is more of a wait and see as things evolve. And the world is evolving, the PRI is evolving, and they are always looking at their guidelines.

THE INQUIRY CHAIR: Are there any further questions?

MS LE COUTEUR: On page 13, 3.1.4 is headed “ESG integration and active ownership”. Basically we are saying here that this actively is not where you are going. I did not think it was, but some people that I have spoken to thought that might be actively not what you are doing. It talks about exercising of all voting rights, and effectively what you are saying is that you are not exercising voting rights insofar as you are not influencing how the voting is done. The shares may be voted but you do not influence how they voted.

Mr Broughton: The answer to that is that we have not actively intervened on a vote since we have been signed up to the PRI, but what we are attempting to do is to ensure that our fund managers are adopting those principles and applying those through their voting policies. We have been through the discussion about just how resource intensive it would be for us to check every one of the votes.

MS LE COUTEUR: Ms Smithies, you talked about the difficulties of advising the minister to vote in any particular way, but at any stage—sorry, is that unfair?

Ms Smithies: He is not difficult to advise per se.

MS LE COUTEUR: I was not meaning it like that, Ms Smithies. It was more—

Mr Barr: Maybe you were!

MS LE COUTEUR: No, I was not. There are considerable issues. Has Treasury at any stage in the past had formal policy advice to, presumably, a minister in the past, saying that the situation is as you explained—that there are 5,000 votes or whatever a year, we have looked at the policies of our managers and we think that, all things considered, this is the best that can be done? Have we actively said that this is as good as, practically, we can do it or is it just that we have not done anything about it?

Ms Smithies: It is certainly an issue that we have discussed. In terms of formal policy advice, there would not be a paper trail on that per se, but they are certainly issues that we have discussed.

Mr Broughton: We have of course received a score card on our implementation of the PRI and that has come up quite favourably. That has been communicated to the minister in the past.

THE INQUIRY CHAIR: Are there any further questions?

MS HUNTER: I have one about positive private equity investments and what level of return we have managed to achieve. It looks like you might be in the spotlight, Mr McAuliffe.

Mr McAuliffe: These programs tend to evolve over about a 10-year time frame, so our fund 1 is into its fourth year. The way that the portfolio is valued at the moment, it is at the point now where we are going to get our money back. So everything we get from here on—as the investment program is finished and we will get distributions back, we will expect a positive return. But we cannot put a number on it because it is so early.

Fund 2 is only three years, I think, so it is actually still investing at the moment. Private equity funds tend to go through a bit of a J-curve, so they tend to flat-line for a bit before they come back up and make their return. It is a bit hard to answer that, I guess.

MS HUNTER: It is looking okay at this stage?

Mr McAuliffe: Certainly, fund 1 is. Fund 2 has been trying to invest—it copped the GFC and those sorts of things. A lot of companies have obviously gone through a fair bit of stress. But we are fairly comfortable, on the whole, that most of the underlying investments are still travelling okay.

MS HUNTER: On page 27 of your submission, in the last paragraph under 6.2, you conclude that there will be long-term investment capacity constraints. Could you explain what you mean by this?

Mr Broughton: It is simply that we have a policy of not being exposed to any one particular firm, to a large extent, and if we had a very concentrated portfolio of firms that we invest in, particularly if we were required to go down the active or direct ownership route, we may find ourselves running up against problems of having too much ownership in specific companies.

MS LE COUTEUR: Given Ms Hunter earlier said that she thought it was probably only about a third of the ASX 300 that was outside the potentially investible universe, if every part of these bills were implemented, that still gives you around 70 per cent of the ASX 300. That would not seem to be very concentrated.

Mr Broughton: There are two things I would say to that. Firstly, it might be a third of the companies in the 200 but it may well be a much larger proportion of the actual index itself. Secondly, not all of that remaining 70 per cent of companies may well be attractive investments, so we might end up with quite a narrow number of firms that we would actually like to be invested in.

THE INQUIRY CHAIR: Thank you, minister, for that. On behalf of the committee I would like to thank you and your officials for appearing today. When available, a proof transcript will be forwarded to you for you to check and to provide any corrections if you feel the need to do so. There may be supplementary questions from the committee following on from this hearing, having had the opportunity to view the transcript, and I will forward those, if they arrive, via correspondence. Thank you very much.

Mr Barr: I will look forward to that.

Meeting adjourned from 11.23 am to 1.02 pm.

O'HALLORAN, MS LOUISE, Executive Director, Responsible Investment Association Australasia

Evidence was taken via teleconference—

THE INQUIRY CHAIR: Good afternoon, everyone, and welcome to this public hearing of the Standing Committee on Public Accounts inquiring into the exposure draft of the Financial Management (Ethical Investment) Legislation Amendment Bill 2010. I note for information that the committee made a statement to the Assembly on 28 October 2010 setting out how we are going to progress this inquiry.

On behalf of the committee, I would like to thank you, Ms O'Halloran, for appearing today by conference phone on behalf of the Responsible Investment Association Australasia. Have you read the privilege card that was provided and do you understand the privilege implications of the statement?

Ms O'Halloran: Yes.

THE INQUIRY CHAIR: That is good. If you would like to make an opening statement to the committee on the bill, we would be very interested to hear from you.

Ms O'Halloran: Thank you. This is my 10th year in this position of executive director. The Responsible Investment Association was established to support and promote the ideas behind responsible investment and, in particular, to provide training, education and professional support to the professionals working in the industry.

I will begin by making an opening statement about responsible investment as it occurs to the world in 2011. Broadly speaking, responsible investment describes a process where environmental, societal and corporate governance issues are incorporated into investment decisions. There is a very broad church in how that can be executed. There are many different methodologies and the industry is now about 30 or 40 years old, if you take it back to the original products that were sold in the United States in the early 1970s.

Responsible investment has now entered into the mainstream of global finance, which reflects a paradigm shift in awareness about the impact of environmental, social and corporate governance issues on the value of financial assets. The overarching goal of investing is moving away from the maximisation of short-term financial returns towards longer term objectives that incorporate environmental, social and corporate governance considerations.

Institutional investors worldwide have incorporated ESG practices, metrics and analysis as a means of achieving risk reduction and learning more about sustainability opportunities and also generating superior longer term financial returns. The area has grown fairly exponentially and it is forecast to become a mainstream activity across the global financial services value chain in the coming years.

In addition to the view of capital and investment markets, many other stakeholders, including governments and civil society, have also agreed that responsible investment practices will lead to better outcomes in what we call now the new economy. And

emblematic of the new economy are increased concerns over human safety, as witnessed in the events at the Fukushima nuclear power plant and in the BP oil spill in the Gulf of Mexico.

There are also increased concerns about governance and ethics. This was evidenced very viscerally in the analysis of the global financial crisis, where it came from and what caused it. We are also increasingly concerned about weather-related events and other “black swan” natural disasters and the potential economic and human outcomes of those events.

In conclusion, I would say that it is easy to understand why environmental, social and governance issues have now become best practice for global financial and capital markets. Negative and positive screening in this regard, what we would term as ethical investment, is an important part of this landscape, but it is not the only part.

I would perhaps like to leave it at that and be open to questions about what the distinctions are here and that they are not mutually exclusive but perhaps are areas that can complement each other, augment each other or remain as distinctly different practices, depending on the outcomes that need to be achieved.

THE INQUIRY CHAIR: Thank you for that. Could you perhaps start by giving us some commentary on the bill itself. Have you read the bill and would RIAA be supportive? Are there any downsides to the bill and are there any positives that you think could be included?

Ms O’Halloran: As far as I see it, I would very much applaud the government for being one of the few sovereign institutions in the world to take this on, because I do believe it is a matter of civil society. As I said, I believe that the extent that—

THE INQUIRY CHAIR: I might interrupt. It is actually an exposure draft of a bill from one of the Greens members of the Assembly at this stage. We are just inquiring as to whether or not it should go ahead. And at this stage the government is not particularly supportive of it.

MS LE COUTEUR: Not supporting it, no.

Ms O’Halloran: Okay. What I would say is that, having also had discussions with the Greens about this paper and looking at the purpose behind it, my analysis of it would focus very much on what outcomes are needed and wanted by the government in pursuing any form of responsible investment—any particular, I suppose, practices within that realm of responsible investment. From a risk perspective, I think it almost goes without saying that this information can very much add value to research and to analysis. So it really needs to be adopted as best practice that environmental, social and governance issues are incorporated into all investment decisions.

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

MS LE COUTEUR: Absolutely. Certainly, on each particular item there could be a whole day or week of discussion on that. But what we are mainly going to discuss is the concept rather than the specific items—uranium, tobacco or whatever. One of the things we have been discussing with the government is that they have told us they do not believe there is sufficient data easily available or available at any sort of reasonable cost to identify companies which would be caught up by the negative screen. Would you be able to tell us about what research is available on companies and whether any of it would cover any of the items proposed in the negative screen?

Ms O’Halloran: The field of research—and is this across international and Australian equities portfolios?

THE INQUIRY CHAIR: Yes.

MS LE COUTEUR: Yes, preferably, or just Australian otherwise—but preferably both.

Ms O’Halloran: The research on supply, if you are talking about supply chain nuances involved in ethical investment screening, has been an area of endeavour in Australia for over 23 years. There is constant enhancement of research in the area that is able to identify where there are sensitivities around ethical investment negative screens along the supply chain—so not just immediately identifiable through a parent company but also through the chain of companies that that company relies upon in its supply chain.

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

THE INQUIRY CHAIR: If I wanted to find out, for instance, what percentage of Woolies’ sales were tobacco, could I find that out?

Ms O’Halloran: Yes.

THE INQUIRY CHAIR: And Woolies are now a big owner of poker machines. If I wanted to find out how much of their income was from poker machines, could I find that out?

Ms O’Halloran: Yes.

THE INQUIRY CHAIR: Where would I go to find that out and how would I go about it?

Ms O’Halloran: There are a number of organisations operating covering the Australian Stock Exchange; that would be CAER, SIRIS, the MSCI, Regnan. I do not want to leave anybody out.

THE INQUIRY CHAIR: No, that is okay.

MS LE COUTEUR: It is enough to demonstrate your point.

THE INQUIRY CHAIR: You make the point.

MS LE COUTEUR: It was also suggested by the government that, to the extent information was available, it would be prohibitively expensive. Obviously you cannot make any precise comments on costs, but in the general scheme of investment research that would clearly be done anyway, could you make any commentary on whether it would double the cost, be less than that—any proportionate idea—because that is what the government says.

Ms O’Halloran: To go through and identify supply chain issues or to identify subsets of the parent company’s activities?

MS LE COUTEUR: To identify whether or not an investment was involved in liquor, tobacco, et cetera.

Ms O’Halloran: And to what degree?

MS LE COUTEUR: And to what degree. The proposed legislation has a five per cent cut-off, so if it is less than five per cent it is—

Ms O’Halloran: Yes, I understand, okay.

MS LE COUTEUR: We are trying to avoid people who are just incidentally involved in things.

Ms O’Halloran: Yes. This is—

MS LE COUTEUR: Would you have any—

Ms O’Halloran: Yes, I would certainly be able to comment on that. The Responsible Investment Association conducts a certification program and through that certification program there is also a third party independent verification which checks on the end product—let us say the fund’s claim as to what kind of ethical and sustainability methodology is used and employed in determining a final portfolio of stocks.

I am using this example because the funds in Australia are, by legislation, under ASIC’s 1013DA, required to state very specifically what they do. Through our certification program we require that they do what they say they do. And to do that they have to describe their systems, their methodology and their thresholds, such as, for example, your five per cent—noting the five per cent cited.

We very specifically have been conducting this review process for about six years now. If there is not specific support for claims made, these are always further investigated. But what this goes to show is that the funds are informed by research, and it is research on the Australian stock market. So these research practices are already well established.

MS LE COUTEUR: Have you any rough idea of how much, if any, this research would add to the cost of managing investments? The government has expressed the belief that it would be prohibitively expensive.

Ms O'Halloran: The funds that are offered—and when one looks at their management fee or the fee that is applied that might be different from a regular fund, it is important to look at how these fees might vary from what we call passive investing. One must compare apples with apples. So across the board any type of selective investment, what we call active investment, will incur probably a slightly larger fee. That fee could range from, say, 25 basis points extra through to maybe 100 basis points extra. So that is one-quarter of a per cent.

MS LE COUTEUR: Yes, to one per cent.

Ms O'Halloran: Through to maybe over one per cent more than a regular fee. Those fees vary, but I think it is very important to point out that most active funds charge a larger fee. So because ethical investment screening requires active investment, thereby it would fall into the same category as the government investing in any other actively managed fund. And to answer your question, yes, it does cost more money and it does take more resources to do that. Again, one would want to match this up against the objectives and the outcomes that you are seeking.

MS LE COUTEUR: Absolutely. I know in the past there has been some half-hearted discussion about establishing an ethical index fund, which would avoid some of those issues and it obviously would be a fairly lowest common denominator of the things that most people are concerned about—tobacco and armaments probably would be number one. Is there any more discussion happening along those lines?

Ms O'Halloran: There has been an index product available in Australia for a couple of years. It is provided by SAM, which is Sustainability Asset Management, which is one of the world leaders in sustainable investing. That product is called the AuSSI index, which stands for Australian Sustainability Index. It is published in the *Australian*, I think, every day or every week. But that is the one that comes to mind.

THE INQUIRY CHAIR: Can you tell us how that fund has performed? One of the first to give us evidence suggested that ethical funds perform as well as if not better than standard funds. Have you got any knowledge as to how the AuSSI goes?

Ms O'Halloran: In particular the AuSSI? As an index fund, I can give you probably an even better indicator of performance by going across the board because I do not think identifying any one fund is probably a fair analysis of the style.

THE INQUIRY CHAIR: No, that is okay.

Ms O'Halloran: The Responsible Investment Association conducts a benchmark report every year. The idea of that is to provide a broad analysis of the relative performance of responsible investment, ethical investment and sustainable investment funds in Australia. I refer to our most recent report, which was published at the end of last year. Regarding the specifics of AuSSI, I do not have that at hand at the moment

on a comparative basis. But what I can tell you is that the performance of responsible investment funds last year was outstanding. We have 12 categories. Four of those categories fall into Australian shares, so let us have a look at that. The average Australian responsible investment fund performed at 15.09 per cent in the year to June 2010. The average mainstream fund, which is its peer comparison, performed at 11.56 per cent. The S&P performed at 13.05 per cent.

The next category is three years. The average responsible investment fund in the three years to June 2010 performed at minus 7.5 per cent, with the average mainstream fund performing at minus 8.05 per cent. At five years, the average responsible investment fund returned 5.14 per cent compared to a mainstream fund at 3.7 per cent. And at seven years it performed at 9.95 per cent compared to 8.75 per cent for the mainstream. So we have got four leading indicators there at a period up to seven years performance, all of them in Australian shares outperforming their apples versus apples mainstream fund competitors.

THE INQUIRY CHAIR: Is that a publicly available document?

Ms O'Halloran: Yes, it is. It is on our website.

THE INQUIRY CHAIR: Thanks for that. You call yourself “responsible investment” rather than “ethical investment”. Is there a reason for “responsible”? Is that to pick up on the language that is used around the world or is that a decision that you made?

Ms O'Halloran: May I explain it from our perspective. I mentioned earlier that responsible investment is a practice that has been evolving for over 30 to 40 years. In that time, like the investment markets themselves, the practices have matured and sophisticated. Because of that there are many different subsets of methodology and approach and each approach goes with a particular outcome or aim that somebody is wishing to pursue.

If I could put it in plain terms, I would say that for ethical investors the aim is that their investments are in line with their values. This means that they would pursue investments that provide a positive outcome in society and for the environment and as far as ethics in governance goes. At the moment, the investment worldwide represents about two per cent of the world's funds under management, and that is an aggregate of world markets such as the United States, Europe, Asia, Australia, New Zealand and Canada.

The next category, I would say, are those who wish to pursue a strategy or a methodology within the larger world of responsible investment that particularly goes towards sustainability outcomes. It is very positively focused, so it is not so much about values but about sustainability outcomes. If I may, I would like to draw the distinction here that there can be an awful lot of overlap. But a parent who seeks sustainability outcomes because they are concerned about the world that their child will grow up in can be different from seeking the kind of values that might be found in an organisation that would like to pursue ethical investment because it is in line and provides integrity with the other pursuits of that organisation, such as a charity, a religious organisation or somebody who works in a non-profit organisation. So

sustainability outcomes are slightly different in that they may not involve a values judgement; they may simply involve the desire to see a more sustainable world.

The third category that I would describe is a category where a growing amount of the mainstream are going to and where increasing amounts of research are now being conducted, which is the area of what we will call materiality. How much do these issues affect investment value? That is an area where we look at issues of risk, such as the risks that we believe that BP oil were taking in safety issues around the Deepwater Horizon oil rig, the risks that we now know about with regard to the TEPCO nuclear power plant in Japan, the kind of risks that were being taken with subprime loans within organisations such as Bear Stearns before, and as we led into the global financial crisis.

I am trying to draw, I suppose, the way that methodology has grown and gone in slightly different directions. We would say that the overarching aim is that these are all methodologies that wish to take environmental, social and governance issues into account. Why they want to take them into account and for what outcomes is the next question to ask, which I suppose takes me back to my opening comment, which is that it is very important, when you develop any strategy, to look at what you want to achieve. There are so many different methodologies that can achieve and align with government policy. I think this is why it is important to take a strategic perspective on this rather than, I suppose, seizing upon a structure that seems preconceived when really there are so many options now to tailor-make responsible investment.

But the very basis is that we believe the world should be looking at these issues as risk issues. They have become risk issues and for any portfolio management it is the most important issue. So in this way it is a fiduciary duty to take these issues into account at a risk level. How much further one would want to go with regard to opportunities is also a risk because an opportunity can be a missed opportunity which can then lead to being a risk. So if you are looking at somebody not engaging in the implications of a new economy and the dynamics of a new economy—and that means a new sustainable economy and it means a new economy that is more regulated than before—if businesses are not looking at these issues and not planning ahead for these issues and are perhaps burying their heads in the sand, that becomes a risk in itself.

Looking at opportunities is the about-face or the opposite side of the coin to risk because it means that you are seizing on an opportunity which means you will be in a better competitive position. So that is the risk story, that is the materiality story, that so many global institutions have now adopted.

THE INQUIRY CHAIR: All right.

Ms O'Halloran: Is that clear?

THE INQUIRY CHAIR: Yes, that is fine. Part of the government's problem—we had the government before the committee this morning—is that they claim it is very hard to define what “ethical” is. How would your organisation define ethical investment?

Ms O'Halloran: Ethical, by nature, is a subjective area. That said though, I think that

anyone who has ever looked at the millennium of philosophy on offer would know that there are some common ethics that can be applied to all of society. These are usually the issues that most ethical investment funds adopt. I do not really agree that ethics is so subjective that we cannot find common goals amongst societies across the world. And being a big fan of philosophy, I have to say that this is quite a studied answer as well. This is why we have ethical investment funds and it is why they have broad appeal across certain markets, because there are common goals of society that people agree upon as being relevant.

THE INQUIRY CHAIR: All right.

MS LE COUTEUR: One of the things the government also have talked about is that it would be very hard to transition from their current portfolio to a different one. Have you any comments about that and what sort of time frame would be reasonable and any idea of the sort of costs that could be involved in it?

Ms O'Halloran: I mean—

MS LE COUTEUR: You do not have details of the government's portfolio so if that is a bit too—

Ms O'Halloran: I appreciate that. I will try and answer this in a way that is helpful.

THE INQUIRY CHAIR: Before you do that, if you want to take it on notice and get back to us, that is another alternative.

Ms O'Halloran: I would prefer to answer now. I think that, like any good, healthy strategy, it does take a degree of organisational change and buy-in. It is about having the right attitude at the outset and it is about seeing this as a win-win. Twenty-five per cent of all funds under management in the world have now adopted responsible investment practices or are in the process of building responsible investment practices. The Responsible Investment Association has actually designed the world's first global online learning institution to augment this—to actually accelerate this process and to educate those on how implementation can occur.

The transition to a portfolio and to investment decision making that includes more information and better information about what is really driving financial value is only a move in the right direction. So an investment in a strategy of this type is money and time very well spent. I would not be seeing it as a cost; I would be seeing it as a potential outcome where there are not only financial outcomes, lower risk, but there are also benefits to society and the environment.

I suppose I do not agree with maybe the basis of that question—that perhaps this is only a cost, when really some of the world's largest institutions are pursuing this because they see it as having the potential to reduce risk and also to open their minds towards real opportunities in the new economy. So, yes, there are cost implications. The cost implications come into account when you look at research, and in training those who receive investment mandates or ensuring that you choose investors who already have adopted the integration of environmental, social and governance issues into their investment decision making.

Much of this is already a very well oiled machine. So I would not be afraid that you would be on the front lines experimenting. This is a well trodden path and there is much data to guide the government in this journey. And there are a lot of very good tools and very good financial outcomes to boot. So when one looks at a cost one also should look at a projected upside in the investment outcomes.

MS LE COUTEUR: Also looking at possibly a potential upside rather than the way the government have presented it; they have suggested that if we were to go down this route we would have major problems in terms of an insufficiently large investable universe—that there would be too much concentration of where we had to invest and thus too much volatility and reduced returns. Apart from the comments that you made earlier about the funds managers performing well, have you any other more general comments about this?

Ms O'Halloran: Yes. The art form of any investment practice is to reduce volatility, and risk adjusted returns. So the outcome of any investment process is to achieve higher risk adjusted returns. The art form involved in ethical investment, and particularly if it involves negative screening, is that there are replacements made that will not just neutralise that but perhaps enhance the outcomes of that portfolio as a whole. So the old adage of reducing the portfolio universe has not really played out in any studies that I have seen on volatility.

That is regarding negative screening, but I would like to make the point again that not all responsible investment practices involve negative screening. It could turn out that negative screening has enormous benefits for the government, but this is an area that one would want to study in practice and actually determine what the outcomes you are looking for are. There are outcomes with regard to leadership and with regard to sending messages and other outcomes that go to aligning the government's purposes and integrity with their investment decision making.

But at the very least I would say it is quite beholden on governments to reduce risk in their investments and to seek out investment opportunities that will not put them at an investment disadvantage. So taking environmental, social and governance issues into account becomes fairly basic best practice.

There have been studies conducted over recent years by organisations such as Goldman Sachs, Aviva—which is one of the world's largest global investment organisations—our own AMP Capital Investors, and a very well respected professor from New York University. Each of these studies shows that in the last 40 years or so the tangible value of a company has fallen from 95 per cent to 24 per cent. The rest becomes intangible value. The studies have shown that anywhere between about 73 and 82 per cent of a company's value in 2011 now resides in what we call intangible value. That intangible value is largely occupied by environmental, social and governance issues. It is about human capital management. It is about management of supply chains and the particular target investments, management of environmental risks. It is management of its own internal ethical procedures. These issues go to some of the big events that we have seen which have caused such a diminution in the value of our stock markets globally.

I suppose I go to this on two levels. Ethical investment screening is a very important strategy for organisations wishing to align their public policy outcomes or their public policy goals with their investment decision-making processes. But taking environmental, social and governance issues into account with regard to risk is a fairly fundamentally important practice in the world that we live in at the moment.

MS LE COUTEUR: Do you know of any examples of any other governments that are taking either a responsible or an ethical investment approach?

Ms O'Halloran: From a government perspective, the last time I looked the ACT government was the only government in the world that had done this.

MS LE COUTEUR: Do you mean the UN principles of responsible investment?

Ms O'Halloran: Yes. You can call it the PRI. I am sorry that my information on this is perhaps a year out of date, but when I last looked I believe that at the time I did observe that the ACT government was the only government in the world. But that being said, in the eyes of the PRI, the ACT government would sit also in line with sovereign funds. If you include sovereign funds in that, if you include ACT government as a sovereign fund, there are a number of sovereign funds around the world which have adopted both ethical investment screens and ESG materiality decision-making processes.

A negative screen is a relatively straightforward process in that certain industries or companies are excluded and are replaced in order to provide maximum diversification. But for ESG materiality screening or decision-making processes, it requires that information is received on top of the general research that the analysts will use. And that extra research provides far more and greater depth on the true value of the target investment, the risks it may be exposed to and the opportunities that may be ahead for it.

THE INQUIRY CHAIR: Are you able to provide us with a list of sovereign funds that have adopted these principles, that you are aware of?

Ms O'Halloran: Most certainly, I can do that. Off the top of my head, New Zealand has been a leader in this, the New Zealand superannuation fund, which is a sovereign fund, and the Norwegian pension fund. A number of other funds based in the Netherlands and other Nordic countries have adopted not just ESG materiality screening but also some ethical exclusions. Many of these go to very high level issues such as the outlawing of cluster bombs but some have adopted tobacco as a screen because, of course, it is seen that this increases the health expenses of the particular government or country in which it is operating.

THE INQUIRY CHAIR: Earlier you touched briefly on the ability to influence. Regnan yesterday suggested that perhaps the bill was not the best way to go, that sometimes you are better off being inside the tent than outside, when you can use shareholder motions and your ownership of shares to influence the way in which companies operate. Do you have an opinion on that?

Ms O'Halloran: I suppose the view of the Responsible Investment Association is that

we represent organisations that have adopted a range of methodologies and distribute a range of different products and the purchasers of a range of different products. I do not have a set opinion on what is the best way to go, but if one's objective is to achieve change and achieve improvement in society, environment and governance, there are a number of tools in the toolbox. One of those tools in the toolbox is to conduct negative screening but to highlight the negative screens and to make sure that the organisations who are the target of those negative screens understand that you have done this. And if you are a government and in that position, this can be a very powerful message.

The other point that I would make is that to be inside the tent is also a powerful process. I fully support and agree with Regnan's position on that. There are other tools such as direct engagement and sitting down face to face with the organisation at regular intervals with the appropriate evidence to discuss with that organisation a change of operations, a change of behaviour or a change of policy. That has had extraordinary outcomes across the world.

Some of those outcomes that I can point to would be, for instance, a change in Wal-Mart's supply chain management policy to include any implications regarding human rights for the organisations that exist along the supply chain, and particularly those in emerging nations. Engagement has also caused companies to change policy decisions on the management of environmental issues, the management of climate change issues, the management of their carbon emissions.

Collaborative engagement is another very alive and well process going on in the world. If you are inside the tent you are able to collaborate with other like-minded investors—and for the government, that would be other sovereign funds around the world and also other large pension fund institutions and managed funds—to collectively speak to particular industries on issues of concern to portfolio value, societal and environmental outcomes.

THE INQUIRY CHAIR: A last question from me. You said worldwide about two per cent of funds are in responsible investment funds. Do you know what the percentage is in Australia?

Ms O'Halloran: May I go back to the various classifications that I would want to point out? About two per cent of all funds under management in the world go to what we would call specially named, specialist products, and they would be named with the words probably "responsible investment", "ethical investment", "sustainable investment". Those funds which want to name themselves and have a specialised product name now capture two per cent of the world's funds under management. In Australia we are just below two per cent. I think it is about 1.9 per cent at the moment. In other parts of the world that might be over two per cent. But on average across the world we all hover at around the two per cent level.

But if you wish to look at the mainstream organisations which are taking environmental, social and governance issues into account because they feel that this will provide better investment outcomes and a closer control of risk in their portfolios, these organisations represent 25 per cent of all the world's funds under management at the moment. In Australia that category has now reached over 50 per cent.

THE INQUIRY CHAIR: Where does that data come from and can you provide that to the committee?

Ms O'Halloran: Yes, that data comes from the Responsible Investment Association's benchmarking report.

THE INQUIRY CHAIR: Okay, it is the same report.

Ms O'Halloran: That research is being conducted by CAER, in association with the Responsible Investment Association's established methodology on the research. So it is a disciplined process that takes place for three months every year, of research gathering.

MS LE COUTEUR: Can I ask about a topic we have not touched on yet, and that is the possibility of positive screening or actively going out and investing in certain areas. Have you any views on that? This is the other part of this potential legislation.

Ms O'Halloran: Yes, I do. The world of positive investment activity has grown enormously, of course, since the introduction of government policy and legislation in the area of climate change and carbon emissions. So what this goes to then is that activities which were once, I suppose, considered to be externalities for companies are now being priced by governments and also by the market-based mechanisms.

This provides a clearer idea about the real costs of doing business for a lot of corporations in absorbing the previously external costs into the costs of production. What that does at a larger economic scale is that it means new industries that are designed to take advantage of the new economy pursuits of many different regions around the world become more favourable targets for investment.

To understand from an analysis perspective exactly how a new opportunity turns into an investment target is to conduct a fairly rigorous process of peer analysis on these kinds of investments that relate to environmental reforms, that relate to societal reforms, reforms in the financial market system. That is when you get to what I call positive investment targets and positive investment industries or industries of the future. There is an increasing body of information and research available which makes this task not just an important part of the investment process but also a pretty delightful area of inquiry.

Those areas include water. Water management has become a priority for governments across the world. Just alone, the Chinese government has committed \$1.1 trillion over the next 20 years towards water investment. Most investment analysts would see this as an investment target, and for obvious reasons, because there is an injection of support from government and policy frameworks around that.

Another area, of course, is in supporting microfinance initiatives. There are many large corporations in the world who are now involved in supporting the growth of industries of the future in emerging nations and also in underdeveloped countries and parts of the world such as Africa. So there are an extraordinary number of opportunities but only for analysts who understand and feel comfortable with those

kinds of investment approaches.

Again, it really goes back to the kind of research that is adopted and the understanding that investment institutions may have about those kinds of investment opportunities. Sadly, it is an underexplored area. This is because many people just do not know how to go about it. That does not mean that there are not resources around to employ those methodologies. There are, and they are very sophisticated. Many of these industries have grown to be semi-mature industries, such as clean technology.

THE INQUIRY CHAIR: I think we have exhausted our questions. We would like to thank you for joining us today for this hearing. We will send you a copy of the transcript when it is available so that you can read it to see that we have recorded it accurately and perhaps make any suggestions that you feel are necessary to make sure it is a correct recording of what you have said. The hearing will now be suspended. Thank you.

Ms O'Halloran: Thank you very much for giving me the opportunity to speak.

The committee adjourned at 1.51 pm.