ACT Government

Chief Minister, Treasury and Economic Development

INVESTMENT GOVERNANCE POLICY FRAMEWORK

FOR THE FINANCIAL INVESTMENT ASSETS MANAGED BY THE CHIEF MINISTER, TREASURY AND ECONOMIC DEVELOPMENT DIRECTORATE
("TREASURY")

MADE IN ACCORDANCE WITH THE *FINANCIAL MANAGEMENT INVESTMENT GUIDELINES 2015* AND THE *SUPERANNUATION MANAGEMENT GUIDELINES 2015*
("INVESTMENT GUIDELINES")

This Investment Governance Policy, unless expressly indicated to do so, does not have an exhaustive and binding effect on all investments and investment processes. Where this policy is silent or conflicts with a provision of the Investment Guidelines, the terms of the Investment Guidelines prevail.

Version Control

Version No.	Date	Comments	Approver
1	December 2018	Establish a new consolidated Investment Governance policy framework applicable to all financial investment assets managed through Treasury.	Treasurer

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PURPOSE

The Investment Governance policy framework is established for the financial investment assets managed by the ACT Chief Minister, Treasury and Economic Development Directorate ("CMTEDD"), represented by Treasury.

To facilitate an efficient cash and investment management structure a centralised and unitised investment administration structure is provided by Treasury that can provide for a number of different investment options to meet the specific investment objectives of Directorates and Territory Authorities.

The centralised legislative, governance and control structure has been established for a number of purposes including:

- Consistent application of the Responsible Investment Policy and investment governance;
- Single ACT entity with financial market presence;
- Legislative compliance;
- Economies of scale, efficiencies and systems; and
- Consistency around financial reporting and budgeting.

This policy sets out the governance framework for the selection, management and monitoring of financial investments by Treasury. This document is not intended to be a detailed operational description but rather a general guide to the investment governance oversight of the investment program and policies for the financial investment assets.

This Investment Governance policy framework is to be read, implemented and managed in conjunction with the *Responsible Investment Policy* for the financial investment assets managed by Treasury and Individual Agency Investment Plans.

LEGISLATIVE REQUIREMENTS

The authority for the investment of Directorate or Territory Authority moneys is provided through the *Financial Management Act 1996* (FMA) and the *Financial Management Investment Guidelines 2015*.

- Section 38 of the FMA provides that the Treasurer may invest any money held in the Territory Banking Account or Directorate Banking Accounts in any investment prescribed under the Financial Management Guidelines.
- Section 58 of the FMA provides that funds not immediately required for the purposes of a Territory Authority may be invested by the Treasurer, for the Territory Authority, in an investment mentioned in section 38.

Where parts of an Administrative Unit ('Directorate') have been prescribed as separate Administrative Units and these entities have separate legislative provisions, the relevant acts provide for the investment of moneys by the Treasurer.

This includes:

- Section 11 of the *Territory Superannuation Provision Protection Act 2000* and the *Superannuation Management Investment Guidelines 2015*; and
- Section 80 of the *Lifetime Care and Support (Catastrophic Injuries) Act 2014*.

The Investment Guidelines requires that any investments may only be made in accordance with an '*Investment Plan*' and the '*Responsible Investment Policy*' which must be approved in writing by the Treasurer.

Investment Plan means details about the investment risk and return objectives, strategic asset allocation and investment governance:

- the investment risk and return objectives and strategic asset allocations for each investing Directorate or Territory Authority entity are set out in individual *Investment Plans*; and
- the *Investment Governance Policy* framework is set out in this document.

Responsible Investment Policy means a responsible investment statement of objectives; details about the responsible investment framework; and share voting arrangements, and any other information considered relevant for a Territory Investment Portfolio.

INVESTMENT GOVERNANCE

The Treasurer has the ultimate responsibility for approving the high level strategic investment policies.

The Under Treasurer has responsibility for investment governance, implementation, and operational management activities.

Operational investment decisions and authorisations are made by the relevant Treasury officials in accordance with their financial delegations provided by the Treasurer, delegated in accordance with the relevant provisions of the *Legislation Act 2001*.

INVESTMENT ADVISORY BOARD

The Treasurer appoints a non-statutory Investment Advisory Board to provide advice in relation to matters associated with the financial investment assets managed by Treasury.

The purpose, role, composition, process and responsibility framework for the Investment Advisory Board is described in the *Investment Advisory Board Terms of Reference* available at https://www.act.gov.au/open-access.

ENGAGEMENT OF AN INVESTMENT ASSET CONSULTANT

Treasury engages the services of an asset consultant to provide advice and investment services in relation to the management of the financial investment assets.

The asset consultant provides independent advice in respect of the investment strategy including the setting of investment objectives, strategic asset allocation, portfolio construction, responsible investment policy and practices, governance, investment managers and products, and other investment matters.

CONSIDERATION OF ADVICE

The Investment Advisory Board and asset consultant's advice is considered along with all other available information by Treasury when formulating policy positions and recommendations.

Treasury is responsible for implementing investment policy, including governance, reporting, directing cash flows, and rebalancing, as well as procuring external service providers, monitoring service delivery and managing service provider relationships.

INVESTMENT OBJECTIVES

The investment objective establishes the desired investment return and risk outcome based on the relevant investment strategy. The investment objectives must be measurable and clearly documented in the individual Investment Plans.

The investment return objective is expressed as an annualised, absolute percentage margin return above the Consumer Price Index (CPI), measurable since inception of the investment strategy.

The investment risk objectives may be expressed as the expected frequency of annual negative returns, the expected tail loss return (the expected average return when financial markets are very adverse) and as a measure of expected return volatility (standard deviation of returns).

INVESTMENT STRATEGY

Individual Investment Plans for each investing Directorate or Territory Authority entity invested in the Treasury investment structure are separately prepared and are required to be approved by the Treasurer.

The Investment Plan describes the individual investment strategy for moneys invested in the Treasury investment structure.

The investment strategy broadly describes the suitable types of investment asset class exposures to be included and takes into consideration individual circumstances when formulating the investment strategy including the types of liabilities to be funded, the potential growth in liabilities, the investment horizon, the level of funding, investment risk tolerance, costs and liquidity.

In general the investment strategies adopted will be the main influence on the returns generated. Investment strategies are primarily influenced by the investment objectives and the time horizon over which these are to be achieved.

Investment decisions will be made on an overall risk and return basis incorporating many factors and considerations, including economic and financial, as well as identified environmental, social and corporate governance risks.

INVESTMENT STRATEGY REVIEW

Each investment strategy will be formally reviewed on at least an annual basis to ensure the strategy remains consistent with the stated investment objectives.

Amendments to an investment strategy may be required due to changes in the underlying investing Directorate or Territory Authority entity's financial circumstances, significant economic or financial market events or significant changes in the estimated outlook for capital markets.

Any amendments to an investment strategy will require approval by the Treasurer.

INVESTMENT STRATEGY ASSET ALLOCATION REBALANCING

The primary objective of investment portfolio allocation rebalancing by Treasury is to hold each investment strategy's actual investment allocations within approved allocation ranges to the target strategic asset allocation – a portfolio risk control mechanism.

Treasury may be required to vary the dollar allocations to the underlying investment managers and investment products to maintain the desired allocation weightings.

While the investment strategy outlined in each Investment Plan states the allowable maximum asset class allocation ranges, where applicable, the investment strategy rebalance process utilises a tighter threshold tolerance range approach of +/- 3 per cent for each of the stated investment strategy allocations.

As long as the portfolio asset allocations remain within the maximum specified allowable allocation ranges, and the threshold rebalance tolerance ranges, there is no need to rebalance the portfolio and incur unnecessary transaction costs. This approach is to provide the best trade-off between portfolio risk control and transaction cost minimisation over the long-term.

INVESTMENT BELIEFS

The investment beliefs, developed in conjunction with the asset consultant and Investment Advisory Board, form the core framework for developing investment management policies and for making investment decisions in relation to the financial investment assets under the responsibility of Treasury.

Belief 1:	Beta (market-related risk) is the principal driver of investment returns for the investment portfolio.
Belief 2:	The equity risk premium will be the major driver of returns above the risk-free rate, but the investment strategy will seek to exploit other risk premia such as the credit, illiquidity and term premia.
Belief 3:	Alpha (manager skill) is a secondary driver of investment returns, and will only be used where there is a high level of conviction in the manager's ability to add value on a net of fees basis.

Belief 4:	It is necessary to take investment risk in order to achieve the return objectives, but there is no reward for taking more risk than required.
Belief 5:	Risk should be viewed both qualitatively and quantitatively and particular focus given to the nature and likelihood of extreme events that can negatively impact the reputation of the ACT Government.
Belief 6:	The primary definition of risk for the investment portfolio is the likelihood of negative returns. The extent of negative returns and volatility of absolute returns are considered secondary risk measures.
Belief 7:	Diversification amongst investment managers, asset classes and individual securities is an important part of managing investment risk.
Belief 8:	The ACT Government and Treasury will have regard to environmental, social and governance factors when determining the investment policies and strategies for the investment portfolio.
Belief 9:	As an asset owner it is accepted that both financial and non-financial risks (specifically environmental, social and corporate governance (ESG) issues) can impact on long-term investment value and performance.
Belief 10:	Companies that best manage ESG risks, impacts, and opportunities, should be more financially sustainable in the long term and should deliver better long-term performance.
Belief 11:	Companies that are unwilling or unable to take important ESG issues into consideration may put the company's reputation at risk, cause loss of market opportunities or diminish company value.
Belief 12:	The success of the investment outcomes will be directly related to the strength of investment governance arrangements.
Belief 13:	Costs and fees are an important consideration and all investment opportunities will be evaluated on a net of cost and fees basis.

INVESTMENT RISK MANAGEMENT

INVESTMENT RISKS

The overarching risk management principle recognises that it is necessary to take investment risk in order to achieve the return objectives, but there is no reward for taking more risk than required.

Each investment strategy requires a significant proportion of the investments to be held in assets carrying market risk, resulting in volatility of returns over shorter periods. Diversification amongst asset classes and individual securities is an important part of managing investment risks.

Market Risk

Market risk is the risk of losses due to factors that affect the overall performance of financial markets.

The exposure to market risk is a result of the investment strategy and asset allocation prescribing investments across certain asset classes. Exposure to a wide range of assets will be held with the expectation of resultant returns exceeding the risk-free rate over the long term.

Principal exposures include: broad equity market risk; broad debt market risk, including default risk; foreign currency exposure risk; and broad asset class risk within alternate asset classes such as property and private markets.

Market risk is generally managed through: implementing a risk profile that is considered appropriate for the return objectives and time horizons based on analysis of the risk and return characteristics of the potential investible asset classes; diversification between asset classes to spread risk exposure; and ongoing assessment of risk exposures taking into consideration prevailing market conditions and economic outlook.

Investment Manager Risk

Investment manager risk is the risk that the appointed investment manager may fall short of the objectives for which they are appointed.

Investment managers may be appointed to deliver the equivalent of a particular market return (beta) or to outperform a particular market return (alpha). Investment manager risk is generally managed by: extensive due diligence, evaluation and rating assessment by the appointed asset consultant recommending the most suitable investment managers for use by the Territory; ongoing monitoring and assessment of investment managers by the asset consultant to ensure there is sufficient conviction that each manager will continue to meet their investment objectives and operate within their investment constraints; and diversification in the use of investment managers by the Territory.

Credit Risk

Credit risk (or counterparty risk) is the risk of default by the counterparty on its contractual obligations.

Risk exposures are to remain within approved exposure limits based on the credit ratings of financial instruments and counterparties set out within the strategy, objectives and constraints permitted by individual investment management agreements or trust deeds as relevant, as agreed by Treasury.

Appointed managers of investments are required to ensure: credit quality within the manager's portfolio is within agreed guidelines; the exposure to different tiers of credit are within agreed guidelines; the maximum permitted exposure to any one issuer is within agreed guidelines; and the long-term debt of all entities in which the manager invests is either rated by an approved rating agency or, if it is not rated, is limited to the maximum permitted exposure to such debt.

Liquidity Risk

Liquidity risk is the risk that a security or asset cannot be traded (sold) when required, or the price achieved is materially different from the quoted price, or short term financial obligations are unable to be met when required.

Investment strategies are primarily influenced by the investment objectives and the time horizon over which these are to be achieved therefore providing for illiquidity in relevant circumstances as well as allocations to liquid asset classes as required.

Liquidity risk is generally managed by: maintaining adequate levels of operational liquidity; providing for appropriate diversification of asset classes and security holdings; limiting maximum investment exposures to more illiquid asset classes or assets; and setting appropriate limitations on security holdings or assets in the investment management agreements.

Economic Scenario Analysis

Economic scenario analysis is conducted annually on all investment strategies to consider key factors that may influence achievement of the investment objectives.

The purpose of the risk analysis is to examine the impact of potential adverse economic and financial scenarios on each investment strategy. The analysis estimates the potential impact on returns under each different scenario over a five year period.

The key objective of the risk analysis is to identify events that are likely to be particularly damaging to an investment strategy and consider what actions, if any, might be appropriate to mitigate the impact of these events.

Operational risk

Operational risk arises in the event of deficient or unsuccessful internal processes, people resources (both internal and external), systems, and the use of external investment service providers.

Operational risk is reduced by: segregation of duties achieved by separating the investing function undertaken by the investment managers from the transaction settlement, recording and reporting of investment activities which is undertaken by the custody and investment administration services provider (custodian); and requiring investment managers and the custodian to provide third party covenants or assurances against certain events, have in place insurance arrangements to cover claims in those events, annually confirm the existence and effectiveness of internal controls and procedures, as well as to provide for regular compliance reporting.

MANAGEMENT OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE RISKS

Treasury recognises that financial as well as environmental, social and corporate governance (ESG) performance of companies can impact long-term investment value and performance. Treasury considers that ESG risks and ownership responsibilities should be incorporated in investment decision-making processes in order to mitigate investment risk and improve the sustainability of the investments for the long term.

The responsible investment policy framework and implementation actions are established in the Government's *Responsible Investment Policy*.

DERIVATIVES

A derivative is a financial asset or liability whose value depends on, or is derived from, other assets, liabilities or indices. Derivatives include a wide range of financial instruments such as futures, forwards, swaps, warrants and options that can be traded on an exchange or over-the-counter.

USE OF DERIVATIVES

The use of derivatives is an essential part of the investment and risk management process. Derivatives may be used for the following purposes:

- protecting the value, or limiting changes in value, of an investment of the investment portfolio;
- protecting the return on an investment of the investment portfolio; and
- achieving best execution and transactional efficiency in implementing an investment strategy, achieving an investment or market exposure, or in adjusting an investment strategy, investment or market exposure.

DERIVATIVE CONTROLS

The use of derivatives must be within the strategy, objectives and constraints permitted by individual investment management agreements or trust deeds as relevant.

Derivative contracts held will be valued using a mark-to-market methodology, unless otherwise specifically approved. All derivative positions must be covered by collateral in the form of cash or cash equivalents to offset the investment portfolio's exposure. There must be sufficient assets to meet potential obligations arising from the underlying exposure represented by the derivative position.

Appropriate market standard contractual arrangements such as an ISDA Master Agreement and associated Credit Support Annex must be in place between the investment manager or the Territory and the counterparty in a form satisfactory to Treasury.

Non over-the-counter derivatives must be traded on an exchange which has a licensed central counterparty that guarantees the financial settlement obligations of the exchange traded contracts.

To manage counterparty risk, a derivative trade must be with a counterparty that has an acceptable level of credit risk. The obligations of that counterparty may be collateralised under a credit support annex or the trade may be cleared through an acceptable central counterparty clearing house.

Each investment manager is required to have in place appropriate risk management policies and procedures, in a form satisfactory to Treasury.

INVESTMENT MANAGERS AND CUSTODIAN

ENGAGEMENT OF INVESTMENT MANAGERS

Investments are managed by the engagement of investment managers under an investment management agreement or relevant trust deed, accompanied by (as relevant) a product disclosure statement, information memorandum, subscription agreement, or combination thereof. The agreements document the relevant investment strategy, objectives and constraints, investment compliance and reporting requirements and risk management policies and procedures.

Investment managers and investment products are procured in accordance with a '*Strategic Procurement Plan – Investment Management Services and Financial Products'* made in accordance with the *Government Procurement Act 2001* and endorsed by the Government Procurement Board.

Treasury, in conjunction with the asset consultant, monitors the performance of the investment managers with regard to their obligations and ensures that investment managers comply with their obligations.

Each investment manager (or fund) must provide an independent audit report attesting to internal controls and the operating effectiveness of controls for the investment management services provided in accordance with applicable and relevant auditing standards at least annually.

ENGAGEMENT OF A CUSTODY AND INVESTMENT ADMINISTRATION SERVICE PROVIDER

Treasury engages a custody and investment administration services provider which allows for the segregation of duties by separating the investing function undertaken by the investment managers from the safe keeping of assets, transaction settlement, record keeping and reporting of investment activities.

The custodian provides critical administration services in relation to the management of the financial investment assets including: the registry and safekeeping of assets; trade settlement; income collection; corporate actions; tax reclamation; cash management; foreign exchange; unit registry; asset valuation; accounting; investment performance; and compliance reporting.

The custodian must provide an independent audit report attesting to internal controls and the operating effectiveness of controls for the investment administration services provided in accordance with applicable and relevant auditing standards at least annually.

MONITORING AND REPORTING OF INVESTMENTS

The activities and performance of the financial investment assets are subject to ongoing oversight, monitoring and reporting, including:

- assessment of overall results relative to the stated objectives;
- performance of the investment managers relative to established standards and benchmarks;
- compliance of investments with underlying investment mandates, with any requirements or limitations for specific investment managers and all applicable legislation; and
- monthly and annual financial reporting.

Reporting and disclosure of the financial investment related activity is available from the Treasury website (https://apps.treasury.act.gov.au/publications). This includes the disclosure of:

- Responsible Investment Policy;
- Investment Governance Policy;
- Investment Plans;
- Territory directly-owned share holdings (updated quarterly);
- Sustainability Proxy Voting guidelines; and
- Share voting activity for the financial year (updated quarterly).