



Government of **Western Australia**
Department of **Treasury**

Future Fund Investment Framework

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Future Fund Investment Framework

1. Overview

The 2012-13 Western Australian State Budget included an initiative to establish the Western Australian Future Fund (the Fund). The *Western Australian Future Fund Act 2012* (the Act) was assented on 29 November 2012, and the Fund became operational with the first inflow of funds on 30 November 2012.

The Fund was established with the purpose of redistributing a portion of the State's royalty revenue and investing those funds in order to provide a revenue reserve to facilitate the future infrastructure requirements of the State.

Section 5(4) of the Act provides that assets of the Fund are to be held in the Public Bank Account (PBA) as defined in the *Financial Management Act 2006*, Section 3, and are not to be invested other than in the manner prescribed by regulations made for the purposes of Section 37 of that Act.

Section 5(5) of the Act provides that, notwithstanding Section 5(4), assets of the Fund may be invested in gold.

The Fund has the following features:

- Capital is retained in perpetuity.
- Earnings are retained and capitalised for the first 20 years of operation.
- Earnings may be drawn down commencing from the 2032-33 financial year for the purpose of providing new social and economic infrastructure for the State.
- Contributions initially comprised payments totalling \$932.6 million over the four financial years from 2012-13 to 2015-16.
- Contributions in subsequent years comprise a single annual payment of a minimum of 1% of the forecast royalty income for the financial year.

2. Purpose

The purpose of the Future Fund Investment Framework (Investment Framework) is to establish the overarching investment and governance structure under which investments in the Fund are managed.

The structure and operation of the Fund will be in accordance with the Investment Framework and the Policy Framework as set out below and may be amended from time to time.

3. Policy Framework

The Fund forms part of the PBA and is managed within a policy framework which includes the following as amended from time to time:

Western Australian Future Fund Act 2012

Financial Management Act 2006

Financial Management Regulations 2007

Public Bank Account Investment Policy

Public Bank Account Credit Policy

4. Investment Objective

The Western Australian Treasury Corporation (WATC) will manage the assets of the Fund invested in accordance with the provisions of Section 5(4) and 9(2) of the Act.

The fund investment management strategy is passive, one of “buy and hold”, with assets bought and held to maturity¹.

4.1 Return Objective

The return objective of the Fund is to achieve a historical yield return in excess of the marginal Cost of Funds (CoF) of the WATC over rolling 5-year periods. The WATC CoF represents the opportunity cost of investments to the Fund. A rate of return that exceeds the WATC CoF is consistent with the Fund having the ability to deliver an intergenerational wealth transfer with the positive added value net of inflation.

4.2 Risk Objective

The Fund’s risk objective is that the Fund does not realise a negative return (measured on a historical yield basis) in any 5-year rolling period.

5. Management Arrangement

The WATC has been appointed to manage the investment of the Fund in accordance with Section 5(4) of the Act. The WATC’s appointment is governed by the Service Level Agreement established between Treasury and the WATC for the investment of funds standing to the credit of the Public Bank Account (which includes the Fund). The WATC is paid a Management Fee for the operation and management of the Fund.

¹ The Future Fund is operated as part of the PBA, and is subject to the PBA Credit Policy and PBA Investment Policy. Revision of approved counterparty exposure and maturity limits under these policies may require the sale of asset(s) prior to maturity. An asset also may be sold prior to maturity if it is downgraded below the minimum credit rating prescribed under the PBA Credit Policy and Financial Management Regulations 2007.

6. Operational Rules

In accordance with this Policy Framework, assets of the Fund may be invested:

- a. Under Section 5(4) of the Act in the manner prescribed by Regulations made for the purposes of Section 37 of the Financial Management Act 2006 which govern the investment of the Public Bank Account; and
- b. In gold as provided for under Section 5(5) of the Act.

The management of the investment of the Fund under Section 5(4) of the Act shall be in accordance with the Future Fund Operational Rules (Operational Rules). The Operational Rules set out the structural parameters for the Fund which will achieve the return and risk objectives as defined in this Investment Framework, including:

- the Strategic Asset Allocation (SAA) benchmark for the Fund (see 7 below); and
- the Tactical Asset Allocation (TAA) governing the Fund's investments (see 8 below).

7. Strategic Asset Allocation (SAA)

The SAA is a neutral asset benchmark that is projected to provide a historical yield return in excess of the WATC CoF commensurate with the Investment Objective of the Future Fund.

The asset class composition of the SAA will be restricted to those allowed under Regulation 5 of the *Financial Management Regulations 2007* and will be defined within the Operational Rules.

8. Tactical Asset Allocation (TAA)

The TAA sets out the parameters within which the WATC can deviate from the SAA in order to generate a return in excess of the return over the WATC CoF expected to be achieved by the SAA alone.

The TAA asset classes will be restricted to those allowed under Regulation 5 of the *Financial Management Regulations 2007* and the active management parameters as prescribed within the Operational Rules.

9. Performance Measurement

Measurement of the investment performance of the Fund will be in terms of:

- Historical yield return benchmarked against the target rate of return (WATC marginal CoF); and
- Mark-to-market return benchmarked against the SAA.

Given the Funds strategy is assets will be held to maturity (passive strategy), historical yield provides an indication of the extent to which the portfolio return exceeds the WATC CoF.

Mark-to-market returns are used as an internal performance measure of the Fund Manager to take into account movements in the capital value of the portfolio.

10. Reporting

The WATC will provide reporting with the form, content and frequency as agreed with Treasury and set out in the Service Level Agreement.

11. Governance

Oversight and governance of the Fund will be undertaken by the Borrowings and Investment Sub-Committee (BISC) which reports to the Public Sector Financial Management Committee (PSFMC).

BISC will review the Operational Rules on an annual basis (as a minimum) and make recommendations for changes to the Deputy Under Treasurer (DUT), through the PSFMC, as required. The Operational Rules however, may be reviewed and updated at any time by BISC, and will reflect DUT approved changes to operational parameters, including asset mix, product weighting and maturity limits.

It is envisaged that the Future Fund Investment Framework however, will not be subject to regular updates as it is a high level policy framework. Notwithstanding this, if BISC or PSFMC deems a revision is required, BISC will provide advice and recommendations to the DUT, through the PSFMC. Changes to the Future Fund Investment Framework must be approved by the Treasurer.