

**TREASURER'S INSTRUCTION
GOVERNMENT BUSINESS ENTERPRISES ACT 1995**

GBE 07-44-01

INVESTMENTS

BACKGROUND

Section 44 of the *Government Business Enterprises Act 1995* (GBE Act) provides that subject to section 16 of the *Tasmanian Public Finance Corporations Act 1985* (Tascorp Act), a GBE may invest any funds held in any manner which is consistent with sound commercial practice and the Treasurer's Instructions.

Section 16 of the Tascorp Act provides that a GBE may, and if the Treasurer directs, must deposit money with or lend to the Tasmanian Public Finance Corporation any money that the GBE does not require for its immediate requirements.

DEFINITIONS

Words and phrases used in this Treasurer's Instruction have the same meaning as those used under the GBE Act.

TREASURER'S INSTRUCTION

The Board is to have an investment policy statement which sets out:

- the Board's investment objectives;
- the responsibility structure for managing investments;
- the risks associated with investments;
- the investment management approach of the Board; and
- supporting schedules.

The Board, in preparing an investment policy statement, is to consider the issues raised in the attached Guidelines.

A copy of the investment policy statement is to be forwarded to the Treasurer for information purposes within 90 days from the date of this Instruction and whenever the statement is amended.

ATTACHMENT

The following document forms part of this Treasurer's Instruction:

"Prudential Guidelines - Investment by Tasmanian Government Business Enterprises"

Attachment**PRUDENTIAL GUIDELINES - INVESTMENTS BY TASMANIAN
GOVERNMENT BUSINESS ENTERPRISES****1. INTRODUCTION**

These Guidelines will facilitate Government Business Enterprises (GBEs) investing funds in a manner that is consistent with sound commercial and financial practices. Adoption of a prudential investment management framework will help ensure that risks are identified and managed, and will minimise the scope for significant loss through fraud or error.

The Government wants to ensure that GBEs:

- manage investments prudently and responsibly;
- have access to an appropriate range of investment mediums and products; and
- take maximum advantage of available returns within acceptable risk parameters.

GBEs should adopt a disciplined business planning approach to managing their investments by developing a sound investment framework which:

- recognises the responsibilities of the Board;
- establishes investment objectives and strategies;
- identifies sources of risk and establishes policies and procedures for risk management; and
- establishes internal controls.

2. RESPONSIBILITIES**2.1 Responsibilities of the Board**

Boards have a responsibility to set investment objectives and strategies which aim to maximise the returns on invested funds within acceptable levels of risk. Moreover, Boards should ensure that the policies and procedures used to implement the investment strategies minimise the risk of fraud and error.

To adequately address all the issues involved with investment management, each Board should have in place an investment policy statement.

2.2 Responsibilities of Treasury

Treasury's role, in relation to investment management, is to ensure that prudential guidelines for investment are available to GBEs and to provide advice to the Treasurer on:

- whole of Government risk and investment management issues; and
- whether or not Boards have in place a prudential investment management framework.

Treasury does not have a role in GBEs' day to day investment decisions. However, the Treasurer is concerned to ensure that these decisions are taken within a disciplined framework which has been determined by the Board.

3. INVESTMENT POLICY STATEMENT

Irrespective of size and whether investment is undertaken in-house or by a fund manager, each GBE will have in place an investment policy statement.

The statement will set out:

- investment objectives - what is to be achieved?;
- responsibilities structure - who is responsible for investment decisions?;
- recognition of risks - what are the financial and operational risks?;
- investment management approach - what is the investment strategy?; and
- supporting schedules - detailing delegations, exposure limits and asset class benchmarks.

Attachment 1 contains an outline of a pro forma investment policy statement.

Those GBEs which invest solely with the Tasmanian Public Finance Corporation (Tascorp) should have a relatively straight forward investment policy statement.

A copy of the investment policy statement is to be forwarded to the Treasurer for information purposes.

3.1 Investment Objectives

It is the responsibility of the Board to establish investment objectives which form the framework, and set the overall targets, upon which investment strategies are developed.

Investment objectives will vary significantly between GBEs depending on the service outputs produced and the GBE's overall business objectives. The investment objectives will also depend on whether investment activity is part of the GBE's core business activity or simply a consequence of its business.

Objectives should be stated in measurable terms setting, for example, a desired level of nominal or real rate of return. Alternatively, objectives can be set in relation to a published or constructed benchmark consistent with the risk preferences of the Board.

GBEs should report upon investment objectives in their investment policy statement and clearly demonstrate the link to investment strategies. As the objectives are measurable, investment outcomes must be compared to the objectives and results then noted in the annual report.

Boards should set objectives that are realistic and attainable, particularly as investment performance is likely to vary from period to period. Choosing benchmarks which are relevant to the GBE's business objectives is the most appropriate method of ensuring that the measurement process is meaningful.

3.2 Responsibilities Structure

The responsibility structure for the investment function should be clearly established by the Board setting delegation/authority levels for senior management and, if applicable, external funds managers.

The primary responsibilities of each party should be included in the investment policy statement. The authorities and limits prescribed by the Board for each responsible party could be specified in a schedule to the statement.

3.3 Recognition of Financial Risks

GBEs are exposed to a multitude of risks in conducting business and the nature and extent of these risks will depend upon the business objectives of each GBE. However, the investment process will expose GBEs to specific financial risks which must be addressed by the Board when investment strategies are determined.

For a GBE that invests in variable, or fixed, interest products (for example, term deposits, overnight cash, discount securities or bonds), the major risks are:

- liquidity risk;
- re-investment risk;
- interest rate risk;
- credit risk; and
- (potentially) currency risk.

For those GBEs which also invest in other sectors, the risks are similar but sectoral price risks can be substituted for interest rate risk. Thus, a GBE investing in equities and property bears additional price risk exposure to these asset classes.

Whatever the investment objectives of the GBE, the Board should identify risks which are specific to the GBE's investment powers and preferences and establish policies for their effective management.

It is impractical to develop precise prescriptions for the hedging or management of financial risks as much will depend on a GBE's individual circumstances and the Board's own risk preferences. However, for the risk of default on fixed interest products, it is expected that, for those GBEs investing funds outside of the Tasmanian Public Finance Corporation (Tascorp), the Board will set out a credit risk framework in its investment policy statement which provides limits according to the credit rating of the issuer or counterparty.

Boards should not approve investments which are not considered "investment grade" by the rating agencies. The following tables provide examples of credit risk frameworks:

(a) For investments with maturities less than one year

Credit Rating of Issue or Counterparty		Maximum percentage of portfolio	Maximum percentage with any one counterparty
Standard & Poor's	Moody's		
A1+	Prime 1	100	100
A1	Prime 2	70	50
A2	Prime 3	30	20

(b) For investments with maturities greater than one year

Credit Rating of Issue or Counterparty		Maximum percentage of portfolio	Maximum percentage with any one counterparty
Standard & Poor's	Moody's		
AAA	AAA	100	50
AA	Aa	70	30
A	A	30	10
BBB		10	5

These risk frameworks are examples only. Each Board will need to approve a risk framework consistent with its own risk preferences and investment objectives.

3.4 Investment Management Approach

Investment strategies are the actions to be taken to achieve the desired investment objectives.

Setting strategies initially may be a complex process as there is often a range of strategies available. The Board should consider the following factors in formulating its investment strategies:

(i) Balance Sheet

The type and quantity of assets and liabilities and future projections indicate the amount of capital available for investment.

(ii) Projected Earnings

Projected earnings enable the calculation of the amount of funds which can be added or deducted from investment capital.

(iii) Cash Flows

The quantum and timing of cash flows determine the time frame for, and type of, investment decisions and also the range of products available for investment.

(iv) Tax Position

The tax position of GBEs should not be a significant driver of investment policy. Boards should be cautious of investment products which purport to provide tax advantages.

(v) Risk Preferences

Each GBE will have a different risk preference which reflects the type of business in which it operates. Consequently, investment strategies should consider the risk return trade-off between different investment products and reflect the risk preferences of the Board.

(vi) Investment Products Framework

In setting an investment products framework, the Board should select those investment products which best suit the GBE's investment objectives and risk preferences. Such a framework addresses default or credit risk and quantifies the risk position of the GBE and its expectations about desired returns and investment outcomes.

Attachment 2 contains a non-exhaustive list of potential investment products and investment sectors.

3.4.1 The Risk Neutral Position

Being risk neutral does not mean that a GBE is immune or protected from risk as all investment processes involve some measure of risk. Rather, the Board should evaluate what mix or weighting of the investment products it chooses best matches its risk preferences. The resulting investment portfolio will show the "equilibrium" position for the GBE.

For most GBEs, setting the risk neutral position will be a simple process. However, some GBEs with large "core" funds invested in several asset classes will need to address this task in a rigorous manner and set sector (investment product) limits for each broad category of investment. In this instance, the Board should establish asset limits based upon the market value of the investments and, where applicable, any financial arrangements. The asset limits determined set a maximum and minimum exposure for each asset sector.

3.4.2 Varying from the Risk Neutral Position

The willingness of the Board to vary from its risk neutral position will depend upon its business and investment objectives. However, there may be occasions when a Board might wish to vary investment weightings to increase (decrease) exposure to investment products which are expected to provide greater (lesser) returns in the future.

Investment strategies should clearly outline maximum and minimum exposures in each class of investment product and, where possible, the broad factors that could result in a variation from the risk neutral position. This effectively prescribes a GBE's willingness to accept a change to its risk profile and should be consistent with the risk preferences and investment objectives of the Board.

When documenting the risk neutral position, the following tables provide examples of the process involved:

a. Two Sector Allocation

Investment Sector	Benchmark allocation percentage	Maximum allocation percentage	Minimum allocation percentage
Cash on Deposit	80	100	50
Fixed Interest	20	50	0

b. Multi Sector Allocation

Investment Sector	Benchmark allocation percentage	Maximum allocation percentage	Minimum allocation percentage
Cash on Deposit	25	50	10
Fixed Interest	30	45	15
Domestic Equities	20	35	5
Property	15	20	10
Other	10	15	0

When setting the maxima and minima for each sector, the Board will be constrained by its limits, where applicable, for each investment sector and the combined asset limits. The Board should also outline under what circumstances (for example, economic settings) the respective maxima and minima would be taken in the various sectors.

3.4.3 Supporting Schedules

Supporting the investment policy statement will be various schedules designed to provide the specific parameters within which the GBE's investment function is undertaken. These schedules would usually relate to:

- discretionary limits and delegated authority;
- the investment product framework;
- approved counterparties; and
- asset sector benchmarks.

4. ESTABLISHING INTERNAL CONTROLS

A major risk facing all GBEs is operational risk. Providing safeguards against fraud and error is a key determinant in the investment process.

All GBEs are expected to document their approach to internal control and monitoring processes.

4.1 Internal Controls

Under section 16 of the *Government Business Enterprises Act 1995*, Boards are required to establish an audit committee. The audit committee is responsible for ensuring there are documented policies and procedures which clearly delineate responsibilities, delegations and reporting processes. Issues should include:

- roles and responsibilities of staff involved in the investment process;
- appropriate delegation of investment or transaction powers to responsible officers;
- adequate separation of duties between staff, particularly between those who can enter into financial transactions and those involved in the settlement of those transactions;
- transaction limits for each officer; and
- procedures to ensure that credit/counterparty limits are not breached.

4.2 Financial Arrangements

Financial arrangements are a set of risk management tools that are widely used to enhance returns and minimise risks. GBEs authorised to use financial arrangements must develop and document specific policies and procedures for their use consistent with the relevant Treasurer's Instructions.

4.3 External Manager Control

Where a GBE contracts with a third party(ies) for the management of funds, the Board should clearly document appointment and dismissal procedures. Policies for appointment should state the criteria and weightings for selection, and clearly state the circumstances which could give rise to dismissal. The Board should establish procedures to ensure both the investment performance of external managers is regularly monitored and that an annual review of performance is conducted.

Where a GBE employs specialist or balanced fund managers, the Board should ensure that:

- it employs experienced personnel or consultants to advise on the relative merits of existing and prospective managers;
- it employs experienced personnel or consultants to advise on tactical asset allocation between managers;
- all managers are appointed following a competitive tendering process;
- the investment strategies and philosophies of managers are consistent with those of the GBE as documented in the investment policy statement and the Treasurer's Instructions;
- performance is monitored for compliance with desired outcomes;
- criteria are established for dismissal;
- procedures are documented to ensure security of funds following a manager's dismissal; and
- an independent custodian(s) is appointed for all fund managers.

4.4 Audit Review

Ensuring overall compliance with policies and procedures is an important responsibility of the Board and the audit committee has a crucial role to play in this process. Investment areas should be subject to at least an annual review by internal auditors. Audit reviews, at a minimum, should ensure:

- compliance with the requirements of the GBE Act and the relevant Treasurer's Instructions;
- that current policies and procedures documentation is relevant and up to date; and
- compliance with internal policies and procedures.

The audit review should also assess the overall quality and relevance of internal controls and bring any breaches to the Board's attention. Reports to the Board must include overall compliance with the GBE's Investment Policy Statement, Treasurer's Instructions. Any recorded breaches, corrective action proposed and a management response should also be reported. The Board should ensure that any corrective action recommended by auditors is achieved within a reasonable time frame.

A recommended option for GBEs is for internal audit to also comment on the overall quality of the investment process and reported outcomes when compared with investment objectives.

4.5 Code of Ethics/Gratuities

All Boards should ensure that a code of ethics is produced and disseminated to all personnel involved in the investment process. This should address matters such as gifts, inducements and trading for parties other than the GBE.

The code of ethics must be consistent with, and reinforce, the provisions of Part 5 of the GBE Act.

The Australian Financial Markets Association (AFMA) publishes a code of ethics for its members which could form the basis for this document.

5. REPORTING

The Board should ensure that it produces, or is provided with, the following minimum reports in relation to investment management:

- investment objectives and strategies;
- an annual review of investment performance against the objectives of the GBE; and
- a copy of reports produced by internal and external auditors.

The GBE's annual report should include a comparison of its investment performance with its investment objectives.

PROFORMA

INVESTMENT POLICY STATEMENT

- Introduction

- Investment Objectives

- Responsibility Structure
 - The Board
 - Chief Executive Officer
 - Senior Managers
 - Funds Manager (Internal or External)

- Recognition of Risks
 - Liquidity Risk
 - Credit Risk
 - Interest Rate Risk
 - Currency Risk
 - Equity and Property Market Price Risk
 - Operational Risk

- Investment Management Approach
 - Investment Strategy - Asset Allocation
 - Fund Management Policy
 - Funds Managers
 - Custodians
 - External Advisers
 - Funds Under Direct Management
 - Prudential Framework

Schedules:

- A Discretionary Limits and Delegated Authority
- B Investment Product Framework
- C Approved Counterparties
- D Asset Sector Benchmarks

INVESTMENT PRODUCTS AND SECTORS

- (a) Deposits with:
- i. a bank;
 - ii. a building society;
 - iii. an authorised dealer;
 - iv. the Tasmanian Public Finance Corporation (Tascorp).
- (b) The purchase of any securities
- i. of the Commonwealth or a State or Territory of Australia;
 - ii. guaranteed by the Commonwealth or a State or Territory of Australia;
 - iii. issued, and guaranteed or underwritten, by a bank or building society incorporated and located in Australia;
 - iv. issued by, or on behalf of, a corporation incorporated and located in Australia;
 - v. of a municipal corporation or other local governing body constituted by or under a law of the Commonwealth, or of a State or Territory of Australia.
- (c) The provision of financial accommodation secured by:
- i. a guarantee issued by the Commonwealth or a State or Territory of Australia;
 - ii. a guarantee issued by a bank or building society incorporated and located in Australia;
 - iii. a first ranking mortgage of an estate in fee simple, or of a leasehold interest in land in Australia;
 - iv. a guarantee issued by a corporation incorporated and located in Australia.
- (d) The purchase of land or an estate or interest in any land in Australia.
- (e) The purchase of any shares or any right or option in respect of shares in:
- i. a corporation the shares of which are listed on the board of a member of the Australian Stock Exchange Limited or the shares of which are due to be listed within three months, being shares allotted or issued under a prospectus stating that application has or will be made for listing; and
 - ii. a corporation the shares of which are listed on an overseas stock exchange.
- (f) The purchase of any securities:
- i. guaranteed by an overseas government;
 - ii. issued, and guaranteed or underwritten, by a bank incorporated and located overseas; and
 - iii. issued by, or on behalf of, a corporation incorporated and located overseas.