

20 September 2021

Senate Finance and Public Administration Committees
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Investment Funds Legislation Amendment Bill 2021

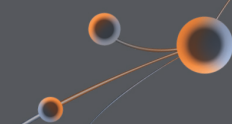
Submission to the Senate Inquiry

Introduction

Research Australia welcomes the opportunity to make this submission. We are the national peak body for Australian health and medical research (HMR), representing the entire pipeline from the laboratory to patient and the marketplace. Research Australia works to position Australian HMR as a significant driver of a healthy population and a healthy economy, and the successful commercialisation of Australian HMR is critical to this objective.

This submission responds to Schedule 3 of the Bill, which amends the Medical Research Future Fund Act 2015 (MRFF Act).

Research Australia understands that the main objectives of the amendments to the MRFF Act are to provide greater certainty about the annual disbursements from the MRFF and to make the disbursements available from the MRFF less dependent on short term volatility in investment markets. Research Australia supports these objectives. Achieving these will enable the MRFF to adopt a more aggressive investment strategy which should raise investment returns over the medium to long term, increasing the total funds available from the MRFF to fund medical research and medical innovation.



Investment returns and annual disbursements

When the MRFF was announced in 2014, there was an expectation in the Government that the \$20 billion in capital would generate an investment return sufficient to make \$1 billion per annum available for medical research and medical innovation.¹² This would require a net annual investment of 5% per annum after fees and charges, which seemed a reasonable expectation. However, this has not been achieved.

Part 3 of the Medical Research Future Fund Act 2015 specifies how the maximum annual distribution is to be determined. Responsibility for this determination currently rests with the Future Fund Board of Guardians. In making this annual determination it places an emphasis on preserving, in nominal terms, the capital of the MRFF over the long-term, and moderating the volatility of the maximum annual distributions from the MRFF from year to year 'to the extent possible'. The Bill repeals Part 3 in its entirety.

Part 4 of the MRFF Act provides for the investment of the MRFF's capital by the Future Fund Board of Guardians, and the creation of an investment mandate for this purpose. Part 4 emphasises the need to maximise the return earned over the long term, and to enhance the Commonwealth's ability to provide grants of financial support for medical research and medical innovation.

The current investment mandate established for the MRFF under Part 4 has set a benchmark average return of 'at least the Reserve Bank of Australia Cash Rate target plus 1.5 to 2.0 per cent per annum, net of investment fees, over a rolling 10 year term'.³ The consequence of this quite conservative investment mandate in a global environment of low interest rates has been that the MRFF has not generated a sufficient return to make available the \$1 billion per annum for medical research and medical innovation that was first envisaged.

Medical Research Future Fund Performance to 30 June 2021⁴

	Return (% pa)	Target return: (% pa)
From inception (22 September 2015)	4.8	2.6
5 years	5.1	2.5
3 years	5.4	2.2
1 year	10.9	1.6

¹ The Hon. Peter Dutton, address to the Press Club as Health Minister, 28 May 2014

² Joint Press Release, 9 December 2014, The Hon. Tony Abbott MP, Prime Minister and the Hon. Peter Dutton MP, Minister For Health, *A Strong And Sustainable Medicare*

³ Medical Research Future Fund Investment Mandate Direction 2015, dated 8 November 2015

⁴ Future Fund Board of Guardians, 26 August 2021, *Future Fund Portfolio Update to 30 June 2021*

This has had significant implications for the annual disbursements from the MRFF. The Future Fund Board of Guardians made a determination in October 2020 that only \$455 million was available from the MRFF in 2021-22.⁵ As a consequence, in December 2020 the Government made available an additional \$172.5 million from consolidated revenue to enable the MRFF to continue to meet the commitments outlined by the Government in the MRFF 10 year Plan for 2021-22.⁶

The MRFF's benchmark investment return is more conservative than that adopted for the Future Fund itself. The Future Fund has been invested with a long term investment horizon, and is not expected to provide an annual income stream in the way the MRFF does. Notwithstanding this important distinction, the MRFF's investment mandate appears to have unduly emphasised reducing short term volatility over maximising returns.

The investment returns from the Future Fund give some indication of what is possible with a more aggressive investment mandate.

The Future Fund Performance to 30 June 2021⁷

	Return (% pa)	Target return: (% pa)
From inception (May 2006)	8.4	6.6
10 years	10.1	6.1
7 years	9.9	5.9
5 years	9.9	5.9
3 years	10.5	5.7
1 year	22.2	7.8

Note: From 1 July 2017 the Fund's Investment Mandate target return was reduced from CPI + 4.5% to 5.5% pa to CPI + 4% to 5% pa over the long term, with an acceptable but not excessive level of risk.

Future disbursements from the MRFF

The MRFF Bill inserts a new Section 15B, which gives the responsibility for determining the amounts available for disbursement from the MRFF to the Minister for Finance and the Treasurer (the responsible Ministers). In addition to giving the determination power to the responsible Ministers rather than the Future Fund Board of Guardians, the responsible Ministers are not required to give any consideration to maintaining the capital of the MRFF. In theory at least, they could determine to draw down the full capital of the MRFF.

The Explanatory Memorandum to the Bill includes the following statement in the outline (underlining added):

‘This amendment will assist in the orderly planning and administration of medical research grants programs. It will also isolate the determination of disbursements

⁵ Future Fund Board of Guardians, 28 October 2020, *Determination pursuant to section 34(1) of the Medical Research Future Fund Act 2015 (Cth) Maximum annual distribution for financial year 2021-22*

⁶ The Hon. Greg Hunt MP, Minister for Health, Press Release 12 December 2020, *\$172.5 million funding top up to support Australian medical research*

⁷ Future Fund Board of Guardians, 26 August 2021, *Future Fund Portfolio Update to 30 June 2021*

from financial market fluctuations, while supporting the perpetual funding objective of the MRFF and better aligning the benchmark rate of return for MRFF with the cost of health-related services.’⁸

With the Bill’s repeal of Part 3 of the MRFF Act, the only reference to the perpetual funding objective will be in the Act’s Preamble:

‘The Parliament believes that the establishment of a perpetual fund capable of generating income over the long term is the most appropriate mechanism for ensuring that this funding is available on an ongoing basis.’

Research Australia is of the view that the perpetual funding objective of the MRFF must be a factor for consideration in the responsible Ministers’ determination of the amount to be disbursed. The responsible Ministers should not be prevented from disbursing more from the MRFF in any year than the fund has earned in that year, but maintaining the long term value of the capital of the MRFF (over a five to 10 year timeframe, consistent with standard investment management practice) should be a consideration when the responsible Ministers determine the amounts to be disbursed.

Research Australia submits that Clause 15B of the Bill should be amended to require the responsible Ministers to take into account the principle of maintaining the nominal long-term value of the capital of the MRFF when determining the amounts to be debited from the MRFF Special Account.

Conclusion

The MRFF is already demonstrating its potential to change Australian HMR, and we welcome the measures outlined in the Bill to increase the long term investment returns available for disbursement. We would be pleased to provide any further information the Committee might require.

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⁸ Investment Funds Legislation Amendment Bill 2021, Explanatory Memorandum, page 4