RAYMOND BRICKNELL

3 April 2009

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600, Australia

Dear Secretary,

Submission to Joint Committee

I am 70 years of age. My wife and I have been living off our Allocated Pension Fund (a SMSF) since I retired from business at 55½, fully self-funded, so I have some considerable hands-on experience of the investment industry.

Furthermore, I was for three years National President of the Australian Investors' Association; and I sold nearly all the shares held by our Pension Fund in August/September 2007 – before the market collapsed – so I have learned a few things from my experience of managing investments. (Our fund is down very little in the recent crash.)

I will make this submission brief, for your sake and mine.

Recommendation 1: Seek to fix the Fundamentals of the industry, not the fine detail.

I have personal experience of company directors and fund managers skirting around the fine print of the corporate law, and they will always be able to do so. They will always be able to afford smarter "specialist" lawyers than those within government – and I mean no offence to government lawyers.

Experience has taught me that government has no hope of writing detailed law which will prevent fraudulent and misleading behaviour. So it needs instead to insert an over-arching preamble into all corporate laws.

An analogy is the provision within the tax act that says, in general terms: ***"If it looks to the tax office like a scheme, then it is a scheme until the perpetrator proves otherwise."***

I have every confidence in the bureaucracy to come up with an effectively worded (short) preamble that would preclude all forms of misleading, dishonest and fraudulent behaviour.

All that is then required is a potential gaol term for individuals responsible for breaking that aspect of the corporate law, along with the loss of fraudulently acquired assets, and suddenly we will have less fraud and dishonesty in the investment industry.
There is a useful saying taught to me once by a wise old Jewish Client: ***The song is in the tune, not the words.*** This is what I am talking about here.

Recommendation 2: Separate the Promoters from the Independent Experts.

We all know the proverb: ***He who pays the Piper calls the tune.***

Product Disclosure Statements (PDSs – formerly Prospectuses) and many similar corporate governance documents are required to contain so-called “Independent Experts’ Reports”.

I spent 25 years in business as a professional Project Manager, managing hundreds of millions of dollars worth of big projects, and I engaged more “experts” than I care to remember.

Some were engaged to advise and design. Some were engaged to provide Bankers with “Independent Reports” with which to cover their backsides if things went wrong – as they so often do in the property development industry.

From this latter group I could always be confident of obtaining a report which was favourable to my Client’s needs. No exceptions. (*He who pays the Piper….)*

So it is with the so-called Independent Experts who provide expensive reports to the promoters of investment schemes. And it will ever be thus unless the current mould is broken.

Many years ago I submitted to ASIC and to Treasury a detailed proposal for a method of obtaining expert reports that were, indeed, independent and professionally sound. That methodology would not only provide increased protection to investors – ALL INVESTORS – in such schemes. It would also reduce the costs of obtaining such reports, and almost certainly eliminate most of the fraud and greed from investment schemes in general.

The fundamental element in that recommendation was to separate the Independent Experts from the Promoters of the Schemes.

It is simple and easy to implement, will cost governments NOTHING to implement, and not increase the workload on ASIC. However, the suggestion was never even acknowledged – even though a Treasury Official I outlined it to at an ASIC function enthusiastically encouraged me to ‘put it in writing’.

That submission is somewhere in my computer archives. I could resurrect it with difficulty, or I could write it again if necessary. But I have no enthusiasm for doing that considerable amount of work unless I have some assurance that government will give it SERIOUS consideration. The ball is in this Committee’s court.

Incidentally, where were the auditors when AIG piled up $500 billion worth of CDS exposure? Maybe derivatives were hard to track. But why didn't the auditors just qualify their opinion? Australia has many equivalent examples of ineffective auditing. A way has to be found to give Auditors more incentive to expose anything and everything that gives them any cause for concern. Simply bringing concerns out into the open, and letting others more expert pry into them, would be a step in the right direction.

Recommendation 3: Get rid of Adviser Commissions.

Commissions paid to Financial Advisers fundamentally create a conflict of interests.

If the government seriously wants investors to get sound professional advice which is aligned to their interests exclusively, then the commission driven investment industry must be fundamentally reformed.

The current global economic crisis has set the scene for such fundamental reform.

Those seeking professional advice in respect of investing money should be asked to pay for the time of the adviser. **Not at the current ridiculously high hourly rates charged by the tiny percentage of Financial Advisers which works for fees – but competition should take care of that problem once ALL commissions were outlawed.**

Once again, this 'fundamental fix' would cost government nothing to implement, and almost nothing to enforce. Just be alert to the innovativeness and creativity of the funds managers in finding ways to get around the law.

In the new 'commission free' investment environment there may well be a case for some ***preliminary*** advice to be available without charge to investors from suitable government agencies – such as Centrelink or the Public Trustees.

The commission system is fundamentally flawed, and cannot be fixed. It must be eliminated and replaced.

<u>Recommendation 4: Offer Investors a Fee Free, Government Managed Investment Fund.</u>

A huge fundamental error was made when the compulsory superannuation levy was introduced. The error was to give the management of the investment of the super funds to private enterprise exclusively.

We now have more Mutual Funds than there are companies for them to invest in. What a ridiculous situation.

And, of course, as Jack Bogle (founder of the Vanguard Index Funds) has been competently pointing out in his books for decades, those mutual fund managers ARE the market, and therefore on average cannot possibly outperform the market. Of course, the recent performance of funds managers as a group has proven beyond doubt that Bogle was right: They add no value whatsoever, and charge on average 2 percent **<u>per annum</u>** of the total savings of their Clients in return.

An alternative could be a **National Infrastructure Fund into which investors may invest at, say, a fixed 7 percent p.a., with absolutely no management fees.** Many studies have shown that this is a reasonable long term rate of return, seldom beaten in the long term by funds managers. But the typical Management Expense Ratio (Fees) of Managed Funds is 2% of capital p.a., which has to come out of the 7 percent (or whatever) return achieved by the funds manger.

The way Australia's superannuation industry is set up at the present time has been severely and rationally criticized by Professor Hugh Stretton in his book ***Australia Fair.*** <u>In it he makes the valid point that about 2 percent of the ***capital*** of the average Australian contributor to superannuation is being gobbled up by fat and relatively incompetent Financial Advisers and Funds Managers each and every year, ***in perpetuity***.</u> You or one of your staff really would find it informative to read at least the relevant chapter of that excellent book – it is available from the Parliamentary Library. (Indeed, the book contains many ideas worth considering by a Labor Government interested in holding power for the long term.)

As at 31 December 2006 there was AUD$1.01 ***Trillion*** in superannuation funds in Australia. Of course, the incompetent funds managers have achieved a 30 percent odd reduction in that total in the past 12 months. Meanwhile, the total is being added to at the rate of at least 9 percent of national income annually. That is, at least 9 percent of very close to AUD$500 Billion in calendar year 2007 ($45 Billion) – even higher now.

Another extremely negative consequence of this funds growth, the way it is currently managed, is that there is too much money chasing too few ***existing*** investment opportunities. For example, Australia has virtually run out of investment grade properties for the Listed Property Trusts (now renamed Australian REITs) to invest in. The "weight of money effect" was constantly driving down yields on investment property before the current crash, to the extent that between 2001 and mid-2008 Property Trust unit prices grew faster than Australian Shares – and that was at a time when share price growth was very strong.

There is a shortage of Commonwealth Government Bonds for funds to invest in, so the **National Infrastructure Fund** could provide a sensible alternative to those – it must be Government Guaranteed, of course. No fixed term – perhaps three months notice for withdrawals?

Such a fund would give the government an adequate pool of money from which to fund a whole raft of much needed infrastructure developments and upgrades. The government is now clearly focused on funding more infrastructure upgrades, whilst at the same time trying to control government spending, so the ***National Infrastructure Fund*** would give it a cost free way of doing this, and at the same time put the brakes on the destructive "weight of money" effect.

Recommendation 6: Mandate that all institutional Funds Managers MUST vote on ALL resolutions of companies in which they directly invest, and must report to their own Investors how they voted on all non-routine resolutions.

There is anecdotal evidence to suggest that the Managers of institutional funds ride on the tails of the managers of the companies they invest in when setting salary levels, etc.

Even more significantly, the evidently habitual failure of institutions to vote their shareholdings clearly serves to reduce shareholder control over companies, and to increase the feeling of powerlessness that prevents the vast majority of individual shareholders from voting.

The consequence of these two things combined is a distinct lack of control by shareholders – the ***owners*** of the businesses. That lack of effective control leads to the abuses evident in executive salaries and perks, with absolutely no accountability in a practical sense.

It is noteworthy that those investors whose funds are managed by institutional Funds Managers have no knowledge of the salaries and perks of their managers, other than in the consolidated Management Expense Ratio. Disclosure equivalent to that required of public companies should, at the very least, be required.

Institutional funds managers could usefully be compelled to vote on the Remuneration Policy of every company they invest in, whether or not that resolution is binding, as well as on all **significant and unusual** Resolutions, and to disclose in a meaningful way to their investors how they voted. The media, if not the individual investors, could then monitor their voting behaviour, publicise it where appropriate, and hence hopefully "keep the bastards honest".

Recommendation 6: Mandate the consolidation of the "Bad Stuff" at the front of the PDS.

The late Austin Donnelly – author of almost 50 books on investing – used to advise investors to read prospectuses “from the back page to the front”. His point, of course, was that all the bad stuff the investor really need to take account of before investing was contained in the (often very) fine (and feint) print in the last couple of pages.

In practice, nothing has changed.

All that is required to fix this is a requirement that every single related party transaction, fee and benefit to the promoters (including all possible benefits), must be consolidated in one place within the first five pages of every PDS, in prominent type setting, and be added to a total and compared in a meaningful way with the forecast prospective benefits to the investors.

The information to be covered by this provision may need to be expanded – the matter deserves detailed analysis.

Such a provision would almost certainly have ensured that the promoters of the failed Rubicon group of investments would not have got away with all the investors’ money.

<u>Conclusion.</u>

I have been telling my local Federal Member for months that ASIC is captive to the industry it regulates. That this always happens to regulatory agencies is well documented.

As an illustration of my point I drew his attention to the fact that ASIC co-published (and probably still does) an investment advisory booklet with the Financial Planning Association in which it is inferred that “investing in shares is safe so long as you stay in for at least five years”. That, of course, is demonstrably rubbish, and is VERY misleading.

Now his Chief of Staff (?) is saying: “***We must put an end to that claim.”***

Of course, he is completely missing the point.

The issue is not the bad advice in the booklet. It is not even that it is fundamentally a mistake for ASIC to co-publish with an industry group it is supposed to regulate.

The issue is that this is an indicator that ASIC is **<u>captive</u>** to the industry it is supposed to regulate. ***ASIC should be dissolved and replaced with an entirely new entity – staffed by virtually all new people – as should all regulators periodically be replaced with new blood.*** Never mind about the potential loss of corporate memory – the turnover in the public service in an environment of “managerialism” is such that no effective corporate memory exists now. Ditto accumulated expertise.

The need for a **major** overhaul of the whole regulatory approach has not only been recognized universally at the recent London G20 meeting. It is also supported by the huge losses in taxable revenue, and the consequential increase in government social security pension payouts, that have resulted from abuses of the previously lightly regulated investment industry.

I hope and trust this Parliamentary Committee does not make the same fundamental error of dealing with the symptoms instead of the complaint.

Kind Personal Regards,

Ray Bricknell