NATIONAL SECRETARIAT

Level 7, 34 Hunter Street, SYDNEY NSW 2000
GPO Box 1595, SYDNEY NSW 2001
Telephone: (02) 9221 1983
Facsimile: (02) 9221 2639
E-mail: association@trustcorp.org.au
Website: www.trustcorp.org.au

Trustee Corporations Association of Australia

31 July 2009

Dr Shona Batge
Committee Secretary
Parliamentary Joint Committee
on Corporations and Financial Services
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Dr Batge

Inquiry into Financial Products and Services in Australia

The Trustee Corporations Association (TCA) is the peak representative body for the trustee corporations industry in Australia.

It represents 17 organisations, comprising all 8 regional Public Trustees and the great majority of the 10 private statutory trustee corporations.

We appreciate having the opportunity to provide comments in relation to the Committee's Inquiry into Financial Products and Services in Australia.

Background

Statutory trustee corporations provide a wide range of financial services to individual, family and corporate clients, including:

- traditional activities, such as estate planning, wills, powers of attorney, deceased estate administration, and management of charitable and other personal trusts.
- superannuation fund trustees / administrators.
- responsible entity for managed investment schemes.
- corporate activities such as debenture trusteeships, securitisation facilities, and custodial services.

Comments

Risk spectrum

The current regulatory framework, based on the outcome of the 1996 Wallis Inquiry, breaks the financial sector into two broad segments:

- the prudentially supervised area, ie: banks, other authorised deposit-taking institutions, superannuation funds (other than SMSFs), and insurance companies.

  Those entities, given their systemic importance, are overseen by APRA with a view to ensuring that, under all reasonable circumstances, financial promises made by those institutions are met within a stable, efficient and competitive financial system.

  They are subject to significant intervention by APRA and characterised by lower risk.

- the remainder of the financial sector, ie: fund managers, finance companies, financial advisors, stockbrokers etc.

  Those entities are subject to ASIC's 'conduct and disclosure' regime, aimed at ensuring that they operate efficiently, honestly and fairly.

  They are subject to greater risk as ASIC's oversight is not aimed at preventing failure. As ASIC points out, licensing of those entities is a 'gatekeeping' mechanism which seeks to ensure that the people who provide the relevant financial services have the competence, integrity and resources to do so, but is not an endorsement by ASIC of the quality of a licensee's business model.

We are not aware that the Government is contemplating a change to that distinction at this time, which provides a risk spectrum to the financial system.

Accordingly, we suggest that the issues associated with the recent collapses of financial service providers, such as Storm Financial, need to be addressed on four fronts:

- consumer / investor education
- advice arrangements
- ratings agencies
- licensing requirements for managed investment schemes

Consumer / investor education

It is clear that many investors in the failed financial services firms did not fully appreciate the risks involved.

We believe that improving the level of financial literacy of the general public is a crucial element in achieving improved investor protection.

This, of course, is not a short term solution.

We are not suggesting that everyone can or should aim to become a financial expert. However, more people should be able to understand key financial concepts – such as the relationship between risk and return, the importance of

diversification, and the power of compound interest - and know where to go for further information and assistance.

We fully endorse ASIC's basic message to investors: *"if you don't understand it, don't buy it."*

We also strongly support initiatives such as the Government's Financial Literacy Foundation, which aims to assist Australians to make more informed financial decisions and better manage their money.

Recent moves by ASIC to provide investors with better, clearer and more consistent information in debenture disclosure documents is another positive step.

In addition, the Government could encourage more attention being given at the school level to basic financial understanding, irrespective of the career path that a student may be following.

Advice arrangements

It seems clear that the nature / quality of financial advice received by Storm etc investors contributed significantly to the losses they subsequently suffered through non-diversification and over-gearing.

In many cases, it appears that the advice could not be regarded as 'independent', given the remuneration arrangements between some product providers and advisors.

The Committee should consider means of ensuring a clear demarcation between product sales and financial advice.

Ratings agencies

The Committee should also closely examine the role played by ratings agencies, such as Standard and Poor's, in the take up of products marketed by the failed entities.

In particular, the Committee should seek to determine the extent to which an 'investment grade' rating influenced individuals and institutions to invest in what turned out to be inappropriate financial instruments.

Licensing requirements for managed investment schemes

The recent difficult economic conditions, which included sharp falls in various asset prices, presented the first serious 'stress test' of the *Managed Investments Act* (MIA) regime that was introduced in 1998.

We believe that the MIA has fundamental structural flaws that contributed to the recent problems, ie:

- there is an inherent conflict of interest within the Responsible Entity (RE) structure that can expose scheme members to unacceptable risk of loss.
- there is a lack of independence due to the fact that an RE's 'external' directors or compliance committee members are appointed by, paid by, and may be removed by the RE.

- timely compliance monitoring is not undertaken by a body independent of the RE.
- 'hindsight' monitoring has been an important contributing factor in a number of corporate failures, eg: the losses suffered by investors in relation to the HIH, Commercial Nominees and solicitors' mortgage scheme debacles.
- there is a lack of appropriate accountability to investors by the RE.
- scheme property is not required to be held by an independent custodian.
- schemes have insufficient financial underpinning - REs with net tangible assets of only $5 million (the maximum required) and $5 million of insurance (the maximum required) hold at risk many billions of dollars of investors' funds.
- where a receiver is appointed to the RE, it is appointed by the secured creditors - whilst the receiver owes a duty to the investors, it also owes a duty to the secured creditors, and these duties may conflict leaving ASIC as the only party protecting the interests of the investors.

We believe that a more robust MIA structure would entail:

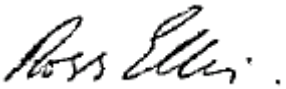
- clearly defining the roles and liabilities of all parties involved in the running and oversight of a scheme, including the financial auditor, custodian, compliance monitor, and any other service providers - importantly, the RE should have full responsibility, and be solely responsible for the prudence of its investments, and hence its performance.
- eliminating the compliance committee and expanding the functions of the compliance plan auditor to encompass:
  - more frequent and timely monitoring the RE's performance in relation to its obligations under the MIA, and each scheme's constitution and compliance plan.
  - monitoring related party dealings.
  - reporting periodically, say quarterly, to the RE and, as necessary, to ASIC on the RE's compliance procedures and the conduct of the scheme.
  - potentially acting as 'investor champion' if action against the RE is required.

  Consideration might be given to appointing a party with a similar role to that of a security trustee in wholesale schemes. That entity could be involved either on an ongoing basis (ie: similar to a debenture trustee receiving and reviewing reports), or be appointed to act where a receiver is appointed.
- widening access to the compliance monitoring role - allowing other qualified professionals to take on this work would introduce more competition in this area and could be expected to place downward pressure on costs.

- strengthening the financial underpinnings of schemes - the regulatory framework should mandate a more meaningful level of capital and insurance for REs and all commercial service providers that has regard to the amount of funds under management and is not capped at a level as low as $5 million.

We believe that such an approach would reduce the likelihood of serious problems arising, and provide more substantial means of compensating investors, with less likelihood of the need to draw on the public purse, in the event of losses due to maladministration, negligence or fraud.

Yours faithfully



Ross Ellis

Executive Director