

29 February 2012

Ms E East
Australian Senate
Principal Research Officer
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Erin

TRIO Inquiry

I refer to the conversation we had following my presentation at the ASIC Summer School last Monday week. Please find enclosed a copy of the power point slides to which I spoke.

As you noted, I have given quite a lot of thought to the best response to address the weaknesses in the managed investment regime exposed post the global financial crises. By and large the system worked well at the mature end of the market. But there are apparently around 500 licensed responsible entities and the weaknesses in the single responsible entity regime were all at the middle to lower end. Absent a return to a statutory requirement for an independent trustee, I think the best response is to significantly strengthen the licensing and registration powers of ASIC. At the moment the provisions are too weighted in favour of the parties seeking a licence or seeking registration. In practice the onus tends to then fall to ASIC to demonstrate a lack of capacity on the applicant's part.

A case in point was the effort ASIC went through to de-licence Opus Capital Limited (a responsible entity of 14 unlisted property funds) over concerns that it failed to have adequate financial resources. See ASIC media release 11-193MR for full details.

Given the experiences in 2009 and following, I think there is a strong case to be made effectively to reverse the onus. People would need to satisfy ASIC that they have the internal systems, capital and governance maturity to discharge the single responsible entity. In some ways the initiative ASIC is taking by strengthening the capital requirements moves the balance in this direction. However I think it needs to be shifted along quite a bit further.

It is interesting to contrast the Australian experience with the approach being adopted in New Zealand. In New Zealand they have maintained the independent trustee role

but are significantly strengthening the licensing requirements around the trustee. Their focus is to ensure that the trustee has the relevant systems and capability to discharge a supervisory role.

I would be happy to expand on these comments if you thought it would be useful. Similarly if the committee were meeting again, I would be happy to attend to be questioned more fully on the observations I have made.

I hope these comments are of some help in your work, and I look forward to hearing from you.

Kind regards

John Atkin
Chief Executive Officer
The Trust Company Limited

COLLECTIVE RISK ?

John Atkin, Chief Executive Officer, The Trust Company
Presenting at ASIC Summer School February 2012

THE TRUST COMPANY

- Established in 1885
- Listed on ASX (TRU) with a market cap of approx \$170m
- RE for > 60 managed investment schemes worth approx \$10 billion
- Replacement RE for 10 of the Trio schemes, Allco MAX, Allco WPF, Everest Babcock & Brown Alternative Investment Trust
- RE roles cover listed (eg Qube, Redcape, PaperlinX and Transpacific hybrids) unlisted retail and wholesale
- Significant corporate trust and custody business in Australia
- Corporate trust business in New Zealand & Singapore

PERSONAL EXPERIENCES

Pre MIA – a glimpse at how the old system worked

- 1990 Estate Mortgage and “*The Business Sunday Run*”

February 2009 – a baptism of fire as the new system was tested for the first time and some myths exposed

- “outsourcing the RE function”
- “RE for hire”
- Compliance plans, compliance committees and the forest of regulation

Exploring the industry structure

OBJECTIVES OF MANAGED INVESTMENTS ACT

Single responsible entity to promote clarity and understanding

Investor protection through

- Compliance Processes – Compliance Committee, Compliance Plan and auditing of Compliance Plan
- Separate custodian where appropriate

Efficiency/Reduction in costs

Worked well at the mature end of the market - the big 5+

Weaknesses exposed at the smaller end of the market

M.I.A. IN PRACTICE

Worked well at the mature end of the market - the big 5+

- Large well capitalised organisations whose business depends heavily on corporate reputation
- Mature internal governance systems
- Sophisticated and professional internal gate keepers

Weaknesses have been exposed at the less mature end of the market

EXAMINING THE WEAKNESSES

Ineffectiveness of compliance regime

- Encourage form over substance thinking by encouraging check list mentality
- Lack of real independence – appointment, fees and removal
- Compliance plan audits ineffective – shutting the door after the horse has bolted and even then limited liability eg Trio

Examples of conflicts – transactions and fee structures

- Allco WPF, Great Southern Scheme inducements, AIT fee stream based on GAV
- Temporary RE provisions ineffective where scheme is insolvent
- Custody arrangements are of limited benefit – interposed entities, contracts and derivatives of MF Global and Opes Prime

SOME INTERNATIONAL COMPARISONS

New Zealand post their “sub prime” crisis

- Multi layered response to systemic failure
 - FMA with forthcoming Financial Markets Conduct Bill
 - Retention of independent trustee role but responsibilities clarified under Securities Trustees and Statutory Supervisors Act 2011
- All trustees required to submit to new licensing regime – FMA highly engaged in reviewing applications to confirm capability

Singapore’s more graduated approach

- Independent trustee not required for business trust but no tax pass through - akin to company with requirement for majority of independent directors
- Restrictions applying for property trusts/SREITs
 - Independent trustee required
 - Limits on gearing - 35% unrated but 60% with appropriate rating
 - Restriction on exposure to development risk
 - Minimum payout ratio of 90%

THE CRITICAL ROLE OF LEADERSHIP AND ACCOUNTABILITY

Professional alliance between managers and governors

- Clarity of roles
- Constructive working relationships with “best interests of investors” as lodestar

The Trust Company approach

- Risk focused governance enabling efficient dispatch of issues
 - Investments within mandate
 - Solvency of scheme
 - Accuracy of accounts and reliability of valuations
 - Security of custody, particularly where interposed entities or derivatives
 - Related party transactions and fee structures
 - Candid disclosure
- Professional fees reflecting responsibilities
- Continually deepen governance capability
- Strong corporate culture around governance with balance sheet support

POTENTIAL IMPROVEMENTS TO M.I.A. REGIME

Address weaknesses in the temporary RE provisions for insolvent schemes

- Moratorium for the replacement RE

More stringent licensing and registration requirements

- Stronger capital base -CP140/RG166
- Ensure capable and mature governance of conflicts/related party transactions
- Require a more dynamic risk focused approach to governance and compliance