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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Reference: Managed Investments Bill

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SENATE

Tuesday, 24 March 1998

JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Members: Senator Chapman *(Chair)*

Participating members: Senators Conroy, Cooney, Gibson and Murray and Mrs Johnston, Mrs De-Anne Kelly, Mr Leo McLeay, Mr Sinclair and Mr Kelvin Thomson

Senators and members attending the hearing: Senators Chapman, Conroy, Cooney, Gibson and Murray and Mrs De-Anne Kelly, Mr Leo McLeay and Mr Kelvin Thomson

Matter referred by the parliament for inquiry into and report on:

Provisions of the Managed Investments Bill 1997

WITNESSES

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CAMERON, Mr Alan John, Chairman, Australian Securities Commission, GPO Box 4866, Sydney, New South Wales 2001 57

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DWYER, Mrs Deborah, Partner, Dwyer Partners, 11 Sheehan Street, Pearce, Australian Capital Territory 2607 25

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. 73

HOWARD, Ms Kerrie, Chairman, Regulatory and Consumer Affairs Forum, Investment and Financial Services Association, Level 24, 44 Market Street, Sydney, New South Wales 37
. 73

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JOHNSTON, Mr John Robert, Private Capacity, PO Box 55, Campbelltown, South Australia 5074 53

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. 73

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. 73

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WILLIAMS, Mr Peter John, Deputy Chairman, Trustee Corporations Association of Australia, Queen Street, Melbourne, Victoria 3000 2

CHAIR—I declare open this public hearing of the Joint Standing Committee on Corporations and Securities. I welcome all of the witnesses who will be appearing before the committee this morning. The purpose of this hearing is to take evidence on the Managed Investments Bill 1997. The committee has already received over 40 written submissions which it will consider, along with today's evidence, in preparing its report.

The committee prefers to conduct its hearings in public; however, if there are any matters which you wish to discuss with the committee in camera, we will consider any such requests. This hearing is being held while both the Senate and the House of Representatives are sitting so committee members may have to leave the hearing from time to time to cast their votes if divisions occur. I hope this will not unduly disrupt our proceedings. The committee has limited time available for today's hearing and a large number of issues to be considered. I ask all of the witnesses to cooperate with the committee by making their comments and responses to questions as concise as possible. We will first hear evidence from parties who are generally opposed to the scheme outlined in this bill and then from those who support the main thrust of the bill.

[10.06 a.m.]

BRADLEY, Mr Graham John, Managing Director, Perpetual Trustees Australia Ltd., 39 Hunter Street, Sydney, New South Wales

CHRISTIE, Mr Donald James, Corporate Trust Manager, Equity Trustees Ltd., 472 Bourke Street, Melbourne, Victoria 3000

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KELLY, Ms Kerrie, National Director, Trustee Corporations Association of Australia, Level 22, 68 Pitt Street, Sydney, New South Wales

MANSBRIDGE, Mr Ian George, Managing Director, Sandhurst Trustees Ltd., 18 View Street, Bendigo, Victoria

WILLIAMS, Mr Peter John, Deputy Chairman, Trustee Corporations Association of Australia, Queen Street, Melbourne, Victoria 3000

CHAIR—I welcome the representatives of the Trustee Corporations Association of Australia and its members. Do you wish to make an opening presentation to the committee before we proceed to questions?

Ms Kelly—Mr Chairman, thank you for the opportunity to speak to the committee in support of the association's submission. The association does appear with a vested interest. That interest is the interest of Australian investors for whom trustee companies currently act.

We are paid to protect investors' interests in managed fund investment schemes. Collectively, the association's members have fiduciary responsibility for $100 billion to $150 billion in managed funds on behalf of some 2.5 million Australians, one million of whom are over the age of 55 or retired.

The committee is probably already aware of the 1994 ANOP survey, which found that around half of Australian managed fund investors are middle Australians—that is, working people; that the average investment is modest in size—62 per cent being less than $20,000; that 55 per cent of these investors believed their investments would be less secure if there was no trustee and a further 41 per cent said that they would consider moving their investments if there was no trustee involved; and that 56 per cent felt that their assets should be held by an independent body. I have brought copies of the ANOP survey for committee members and would like to tender them for your consideration. In relation to the association's submission, Mr Chairman, I ask that the full submission be incorporated in the record.

CHAIR—Yes, it will be published in a separate volume.

Ms Kelly—Thank you. The key points of the association's submission to the committee are that, firstly, investors will not be well protected by the Managed Investments Bill 1997,

as all other major financial jurisdictions require by law that assets for managed funds schemes be held by an independent trustee or independent custodian. This point has been identified by international ratings agencies Standard and Poor's, which said in February 1998:

For investor protection and the safeguarding of assets, it is preferable that an independent custodian at least be retained by funds under an SRE arrangement.

Other examples of reduced investor protection are that, despite the fact that the financial systems inquiry called for the harmonisation of managed investment schemes, with the regime under the Superannuation Industry (Supervision) Act 1993, the bill provides a lower level of investor protection than the regime that applies to these public offer superannuation entities under SIS.

Significant differences between SIS and the bill, highlighted by the leading Australian law firm Arthur Robinson and Hedderwicks, are that under the bill directors and officers of the responsible entity are not directly accountable to investors as they are under current law, thereby removing the sobering test of personal liability for actions of a director or officer of a managed fund. Public offer superannuation entities under SIS are required to have an independent custodian, but a separate custodian is not required under the bill. Unlike SIS, responsible entities of managed investment schemes are not subject to prudential regulation. In addition, the bill removes the real-time daily monitoring of a trustee and replaces it with less effective, after-the-event monitoring by auditors and the government regulator. A compliance plan, as the main focus of compliance monitoring, will not be as effective for investors as if the bill required that the responsible entity must comply with the Corporations Law or the scheme's constitution.

Secondly, the bill does not achieve the government's stated aim of reducing costs and increasing industry efficiency. A study of the cost impact of the bill by leading accounting firm KPMG concluded that:

The increase in ongoing costs resulting from the proposed changes is estimated at approximately $41 million per annum.

Transitional costs during the two-year period of the bill of up to $66 million were also identified. Also of concern was KPMG's conclusion that:

These industry costs would fall more heavily upon smaller fund managers and their investors.

The association has submitted to the committee that the bill creates loopholes that may render the protections intended by the bill ineffective. We have submitted 29 substantive amendments which we ask the committee to consider as we believe that they are necessary to make the bill workable and give it integrity. These amendments fall into four categories: firstly, amendments needed to strengthen investor protection—these include a requirement that all assets be held by an independent custodian, that responsible entities be required to maintain minimum levels of capital at all times and that all officers of the responsible entity be liable to investors if they fail to carry out their statutory duties; secondly, amendments needed to empower investors to enforce their rights; thirdly, amendments required of a

technical nature to overcome poor drafting and to achieve a better result under the bill; and, fourthly, amendments needed to create investor choice and market competition.

This fourth group of amendments would permit the continuation of the existing fund manager/trustee scheme. This model would be appropriate for the management of retail managed funds and would also be appropriate where investors and/or fund managers choose to operate a scheme under this model. As the second part, the government introduced the single responsible entity model for the management of wholesale funds and with a legislative requirement for assets to be held by an independent custodian.

In conclusion, we are surprised and concerned that legislation is being considered without policy statements being available. The association asks that, in its deliberations, the committee does consider investors—of whom, out of 2.5 million investors, only one will be represented here today—and that the committee give serious consideration to the amendments which our association has submitted and which we believe are needed to ensure that Australia continues to have a system in which Australians want to invest.

CHAIR—Mr Bradley, do you wish to make an opening statement?

Mr Bradley—I have an opening submission to make. Thank you for the opportunity of providing some evidence to this committee on this important and complex bill. I regret the inadequate time afforded to the committee to complete its review of this complex bill, a bill which will overturn the contractual rights of millions of Australians. I am aware of a large number of organisations and individuals that would have made submissions to this committee if the opportunity had been advertised and more time allowed. May I take it, Mr Chairman, that my full submission to the committee will be incorporated into the record so that I can avoid having to read parts of it?

CHAIR—Yes, it will be incorporated in a separate volume.

Mr Bradley—Thank you, Mr Chairman. The key issue before the committee, I believe, is whether the protection provided for ordinary investors under the bill is demonstrably better than under the current law. If it is not, then the bill makes unnecessary and costly change for change's sake and should be rejected by the parliament.

We have here a bill which, after almost six years of so-called industry consultation, has elicited, as you know, over 40 submissions on only three business days notice. According to our count, some 80 per cent of those are negative in relation to the bill. They include a complete rejection of the bill—

CHAIR—The bill was referred on Tuesday of last week.

Mr Bradley—We were notified on Thursday, with respect, Mr Chairman. In any event, the submissions were due on Tuesday, so we literally had 3½ business days from the notice.

The submissions that have been presented to the committee include a submission by Fidelity, the largest fund manager in the world with assets of over $1,000 billion under management, which is more than twice the entire superannuation savings of Australia. They include strongly critical submissions from respected senior fund managers such as Robert Maple-Brown, Mike Crivelli, a 22-year veteran of one of Australia's largest fund managers, Bankers Trust, and Mr Doug Little of Tyndall.

We have in front of us a bill that has elicited calls for 30 substantive amendments from our association, 18 or more amendments submitted by the Investment and Financial Services Association in its submission to the Treasurer only three weeks ago and some 50 amendments put forward by the Australian Shareholders Association in its submission to this committee, of which a dozen go to major matters of fundamental principle.

We submit that none of this suggests that the bill in its current form has the hallmarks of a new law that will clearly and demonstrably improve protection for Australia's growing ranks of investors in managed funds. The evidence suggests that there is no lack of confidence by investors in the current trustee manager arrangements. The managed funds industry is growing strongly in this country. Retail funds grew by $20 billion, or 26 per cent, in the last 12 months, up to $110 billion. There is no lack of confidence in the market because the current law is simple, cheap and provides effective investor protection.

I believe that the current manager/trustee arrangements based on private contract and private enforcement are more satisfactory than those based on regulatory enforcement and that they have a basic integrity to them. What I mean by integrity is that they have a quality of being wholly sound, honest and unimpaired. There is a logic, pragmatism and neatness about the two-party structure. It is based on a sound principle of separation of powers. It is always risky in business, as it is in government, to concentrate power in one organisation without effective checks and balances. I will quote from the Fidelity submission to this committee:

> Just as separation of powers is clearly recognised as an essential prerequisite in a democratic political system, in the same way effective checks and balances are surely just as essential requirements if the interests of investors in managed investments are to be fully protected. *Indeed, practice in major overseas jurisdictions requires* separation of powers.

Mr Chairman, I seek leave to have the Fidelity submission, which is only two pages in length, read into the record in its entirety.

CHAIR—There being no dissent, it is so ordered. The submission will be included in a separate volume.

Mr Bradley—Under the current law, the roles of manager and trustee are clear, despite allegations of confusion of roles. We believe this issue was grossly exaggerated by the Australian Law Reform Commission in its 1993 report in order to support a finding that fund managers should be relieved of the irritating necessity to account to trustees as investors' representatives for the operations of their managed funds.

Let me give you three short examples of why the trustee role is essential. Firstly, trustees keep an eye on what fees managers pay themselves out of the investor's money. In a recent case, a manager that had bought a property and then floated a unit trust in order to sell the property into it submitted to its trustee claims for $7 million for work done in the short period that it had owned the property. The trustee found that over $750,000 constituted illegitimate claims, including accounts for work done on different properties and such invalid items as penalties for late payment of payroll tax.

Secondly, trustees make sure that trust deeds do not get amended in ways that disadvantage investors. Again, if I could quote a recent example: a manager proposed to amend a deed to insert a clause that exempted the manager from liability under the deed, including 'through its own negligence'. The trustee objected and the matter was never sent to the unit holders for vote. It did not need to be. The manager removed the prejudicial proposal from the draft. It is interesting to note that the same manager acts as a responsible entity under SIS for private offer superannuation funds, and the same provision exempting them for their own negligence is contained in the deeds of those SIS funds. This reveals one of the safeguards missing from superannuation fund members under a single entity structure.

Thirdly, trustees make sure that managers do not pay inflated prices for assets, especially when they are bought from parties related to the manager. I could give many other examples, but I seek leave to table as a confidential submission a private letter which I wrote to the then Attorney-General, Michael Lavarch, in late 1995, giving further actual examples—

Senator COONEY—A very great Attorney-General.

CHAIR—We do not need comical interjections, Senator Cooney.

Mr Bradley—The letter gives examples of the actual interventions of trustees in certain circumstances, and I believe it would be of great benefit to the committee. May I table that as a confidential submission?

CHAIR—There being no objection from the committee, it is so ordered.

Mr Bradley—By comparison, the current bill has lost its real integrity. Under it, investor protection is impaired in many small ways and some large ones. Our document setting out the amendments necessary to cut out the loopholes, indicates what has been lost. Let me just make three points of comparison in relation to the integrity of the investor protection under this bill.

Firstly, the bill should be compared with the original Australian Law Reform Commission report. A lot more damage has been done to the fabric and integrity of that report than just dropping the requirement for an independent custodian; critical elements have been left out. For example, that report required capital adequacy if you wanted to run a managed fund of five per cent of the funds under management up to a maximum of $5 million. That has now been completely dropped.

We believe the capital adequacy requirement was a fundamental underpinning of the proposal for a single responsible entity. If I could just put that into context: we have in Australia at the moment major fund managers who will be managing, in one case, $35 billion worth of Australian savings with total shareholders' funds of $26 million, with no guarantee from their parent company.

Secondly, the committee should compare the bill with the SIS Act. A lot has been left out compared with the regulation under the superannuation law framework for public offer super. There is no compulsory custodian or minimal capitalisation. The directors are not liable directly to the investors. There is no fidelity fund to levy the industry to compensate

investors if there is fraud or other losses. There is no special tribunal to hear complaints. There are no frequent and rigorous inspection visits by an organisation such as the ISC. Again, I believe a detailed comparison of that regime with this bill will indicate that it has now lost its fundamental investor protection integrity.

Thirdly, the current bill lacks integrity, even compared to the 1995 draft bill. That bill, as a draft, was not introduced into parliament but was released for public consultation when the present government came into office. There are obvious changes. Firstly, there is no independent custodian; that has been dropped. Secondly, the responsible entity has power to change the constitution without referral to the investors. Thirdly, the real independence of the compliance plan auditors has been eroded and, of course, lastly, there is the massive loophole in the shape of the compliance committee option which provides inadequate real independence. It is inadequate in the resources available and its accountability to investors.

I submit that the problems of this bill cannot be simply fixed by putting back the independent custodian. They are more fundamental. The bill we are now looking at looks a lot like the old bill, but it is very different. Removing the independent custodian is like ripping one leg off a three-legged stool: it does not change the appearance much, but it is no longer safe to stand on.

The problem perhaps can be alleviated by a very large number of amendments, coupled with four or five major ASC policies which we have yet to see, provided that they have real teeth. But, even then, I would submit that the bill will be demonstrably inferior in its protection for three reasons. Firstly, it still will not have real time, every day auditing of compliance of every transaction by a truly independent party—that is, the role of the trustee today—that is removable only by the investors; that is paid by the investors and not by the fund manager; that acts under a duty to look after only the interests of investors; that is bound to do so diligently and vigilantly; that is not allowed to make a profit at the expense of the investors, and that has its own capital, assets and insurance on the line for acting diligently and vigilantly every day.

Secondly, we will have a bill that still makes it harder for investors to self enforce their rights because there will be no trustee to take action at the expense, if justified, of the whole fund. It will have the practical effect of requiring the ASC to expend taxpayers' money to take enforcement action and seek civil penalties on behalf of investors—either that, or individual investors will have little redress. In short, the bill relies too much on the regulator which, no matter how competent, is dependent upon the favour of future parliaments for its supply and, by virtue of its closeness to government and the need to act strictly in accordance with rules that can be appealed to courts and administrative tribunals, it is poorly placed to take quick, pre-emptive and bold action to protect investors.

Thirdly, the bill will cost more and give less investor protection. Trustees' fees are tiny. They average $5 to $10 per year for someone with $20,000 invested—and it can be as low as $3 or $4 for very large funds—all of it before tax. Against this, there are the greatly added costs of directors, compliance committee members, extra audits and additional regulation—all that for less protection. We submit that the investors in any future Estate Mortgage situation will be very much worse off under this bill. We ask the committee to

ensure that the bill is either substantially amended to give stronger investor protection or rejected.

CHAIR—Thank you, Mr Bradley. Are there any further introductory comments?

Mr Mansbridge—I wish to make a comment because our company is slightly different from the other companies in the sense that our Bendigo Sandhurst group is located in the country. A lot of the fund managers and many of the trustees are located in places like Sydney and Melbourne, and so we have a slightly different perspective to those located in that area. I think we have always been based on service and trust, and trust is one of the most important things. Our company does not have a large corporate trust practice. We are mainly involved in looking after the mums and the dads. I am also responsible for financial planners and our superannuation area.

The country people generally had fixed deposits and occasionally may have purchased a small property but, as time has gone on, and with the opportunity to purchase shares in a few companies that have been listed recently, more and more, the country people are tending to purchase shares. Obviously, because of skill requirements, managed investments are an attraction for them. The only problem with this is that there are some protections that require people to attend meetings and keep themselves informed. If you ever need to take an action against the SRE, the fact that you are not located within a reasonable distance does pose a considerable problem for our country people. Basically, we would require, and ask you to please set, minimum standards—certainly, an independent custodian. Obviously S&P have quite clearly supported this requirement.

Another situation that I will briefly mention is that in Victoria we have had an experience with a certain company called Pyramid, and I am sure you are all aware of that. When Pyramid failed, there was a fuel tax placed on all our citizens which paid for the mistakes. The government really has set a precedent in this area because they were seen as being responsible through the registrar of building societies. That did not happen with Estate Mortgage, but it certainly happened with Pyramid.

There is a thought developing—and I know some of my financial planners have expressed this already—that, if there is a failure to detect fraud or if the ASC licences an irresponsible entity, some situation will then arise where it will be held similar to the Pyramid situation, in that the government should really do something for them, it should protect them and maybe even provide some funds via a new fuel tax to supplement them.

We have a second concern in relation to the country areas. We have been developing in recent times quite a few innovative new trusts such as vineyards and reforestation, where people are aware, for example, that their small vineyard, which is being run by a very competent person, needs additional corpus to reinvest and develop it. They are creating small trusts which enable them to increase the size of their vineyards or the size of their forest plantations. With the trustees, we have always provided a compliance and a custodial structure and support for all these new trusts. Most of our fees are based on the size of the trust as it develops. Therefore, in the first part of it, particularly with Sandhurst, it is not very profitable for us to do it. But, as these trusts grow, obviously there are monetary benefits for us. Under the new requirements, the costs of establishing these trusts will be

much more onerous. At the present time, it is quite simple for the very large groups to cover that in their normal operation, but what I am talking about here is a small person who wants his $2 million, $3 million or $4 million to increase his plantations.

That ends my submission in relation to the country areas. It is very important that I ask all the committee to consider that, unlike that TV ad that is running at the moment about the fund manager who has multi-overseas degrees and sits on the top of a very, very high building and looks out from Sydney, it does not really relate to my people. Mr Chairman, I ask you to be there for all Australians, and I am sure you will be.

CHAIR—Thank you, Mr Mansbridge. Are there any other opening statements?

Mr Christie—Mr Chairman, we seek leave to have our submission incorporated in the record to save time in reading it.

CHAIR—There being no objection, it is so ordered. The submission will be included in a separate volume.

Mr Christie—We appear today to support the Trustee Corporation Association's submission re reviewing the bill. I am appearing with my general manager in that capacity. In reviewing the bill, we examined it in light of the Australian Law Reform Commission's recommendations, which were to decrease institutional risk and compliance risk. The ALRC recommended the single responsible entity but with prudential regulation and minimum capitalisation requirements, as Mr Bradley has already suggested, and with the independence in that entity constituted by 50 per cent of independent directors.

In our submission, the Managed Investments Bill 1997 seems to walk away from that. There is no prudential regulation. There is the ability to have independent directors, but there is also the ability to have what we submit is a very watered-down compliance committee which does not have the purview of an independent director of either the schemes or the entity offering the schemes.

We submit that the bill fails in its objectives of harmonising with SIS as there are no prudential guidelines for the operators, and there are different standards required of CIS trustees and their officers, SRE entities and their officers and their compliance committees. So, in each case, there is a different standard applied to those people.

We support the TCA in its submission that the Managed Investments Bill 1997 is out of step with other overseas jurisdictions. In our submission, the Managed Investments Bill 1997, in its current form, does not harmonise with the requirements of SIS. It is out of step with overseas jurisdictions and, therefore, it does not provide the level of invest protection which we should seek to aspire to. Thank you, Mr Chairman.

CHAIR—Thank you for those contributions. We will now move to questions. Are there any trustee common funds which operate at the moment without a trustee?

Mr Bradley—All trustee common funds operate with a trustee. That is the nature of a trustee common fund. They are a creature of state law, and they all have a trustee. It is a

statutory trustee company subject to the capital requirements and the prudential regulatory requirements under the state trustee companies acts.

CHAIR—Is it fair to say that the industry is now developing in a direction where trustee companies will move into funds management?

Mr Bradley—Many trustee companies are already substantial fund managers. My own company manages about $4½ billion in public offer funds under a two-party structure with an independent trustee. Other members such as National Mutual, National Australia Bank trustees and ANZ trustees are all parts of groups that are very substantial fund managers.

CHAIR—In that sense there is a blurring of the distinction between the—

Mr Bradley—On the contrary, all of those companies under the current law have to engage an independent trustee to oversight their management of the funds on behalf of their investors. It is the model that we find all around the world.

CHAIR—Under the proposed legislation, given that there is not any prohibition on having an independent custodian, wouldn't some fund managers seek to engage such a trustee company as a custodian as a marketing benefit, as a sales tool for their particular fund?

Mr Bradley—We believe that all responsible fund managers will seek to do that. Certainly many of them have indicated that they will. However, the committee should be aware of the significant difference between that arrangement and the existing situation for trustees. A trustee has much broader responsibilities than a custodian, owes those responsibilities directly to the investors and is paid by the investors. Compare that to a contractual agent as a custodian who is paid by the fund manager, who will have its terms of engagement determined by that fund manager, not by the statute—unlike other countries that set down statutory duties on custodians—and who is likely to have very limited powers or responsibilities to supervise to ensure that every transaction complies with the law, with the trust deed and is the interests of investors. It is a bit like saying that the guard is paid for by the prospective thief and therefore is no guard.

CHAIR—Under the proposed legislation, don't the various mechanisms put in place to protect investors such as the strict duties of liability on directors, compliance plans, compliance committees or independent directors provide protection that may prove to be superior to that of a single trustee, where you have under the proposals a range of protections put in place?

Mr Bradley—Our submission is that when you look at it and see how it all hangs together a lot of things fall between the gaps. It is all very well to have the directors of the responsible entities under a set of statutory duties, but what is the point of that if the investors cannot sue them directly? Secondly, what is the point of having the directors sue a responsible entity if it has no capital and is therefore not in a position to compensate them at the end of the day? You have to look at the full fabric of what looks like an impressive raft of measures all aimed at replacing the trustee. But, when you boil it down, the duties of the trustee are higher than the statutory duties that are placed on the directors under the bill.

Under the current law, managers themselves have those fiduciary duties. History has shown that when pinch comes to shove, when funds fail, the managers tend to be either bankrupt and therefore have no ability to compensate investors. The responsible entities will be bankrupt. In some cases, such as Estate Mortgage, the executives of the fund manager were in gaol for criminal fraud. All of that is cold comfort when you boil it down compared to the ability to look to a credit worthy independent entity that had an absolute duty of diligence and vigilance to look after the interests of investors and is then liable at the end of the day if it fails to do so.

CHAIR—In the instances where problems have arisen in the past, would you concede that in a number of those instances there has been confusion about who in fact has been responsible for investor funds? You have had a lot of litigation between the trustee and the funds to try to determine responsibility. The system really has not worked all that well, so far as investors are concerned. It might have worked well so far as lawyers are concerned, but not as far as investors are concerned. This legislation will reduce the chances of that confusion with the single responsible entity.

Mr Bradley—Your question is an extremely important one for the committee to consider. Our view is that the fact that there have been multiple parties sued in these cases is not an indication of confusion at all. The fact of the matter is, as I have set out in my submission, that trustees have a separate and different set of duties to managers; both are liable for their respective roles to the investors. In the cases that you may be alluding to, such as the Estate Mortgage case, the fact that there have been multiple parties sued, and claims and defences made, is just a normal part of commercial litigation.

Under the bill there will also be multiple parties sued. In every case where there is a loss, investors properly seek to pursue any party that has funds and a liability to protect them. So they are going to sue the directors, they are going to sue the responsible entity, they are going to sue the members of the compliance committee, they are going to sue the auditors of the compliance plan, they will sue the financial auditors, they will sue the lawyers who have given advice, and they will sue the valuers who have valued the property. There will always be multiple parties in large scale commercial litigation. That is the nature of the beast. The fact that court cases take a long time and are complex is a problem with our court system, I submit, and not a problem of confusion of roles under the current law.

At the end of the day in the Estate Mortgage case, investors recouped one of the largest commercial litigation settlements in the history of this country, over $200 million from various parties, the vast bulk of it coming from the trustee, its parent company, which was also sued, and its insurers. That recoupment of over $200 million amounted to between 60c and 70c in the dollar of principal invested by the investors at the end of the day. It would have been better if they could have got it back in a year, but that is a problem with the court system, not a problem of confusion of the law.

CHAIR—Are there any further questions?

Mr LEO McLEAY—You raised some concerns about the amount of time that we have to discuss this matter and to report. The Senate referred this matter to the committee on 3 March and gave us 23 March—20 days from that referral date—for us to report. That is a

problem that you say we have and you are probably correct in that. You say there should be more time. What do you think the benefit for the committee would be in us asking the Senate to give us a later reporting date? What additional information do you think we could adduce, which would help us come to a proper decision on this matter, if we had more time?

Mr Bradley—A number of things, which may be before the committee in a fairly rudimentary way because of the rush of us all to get our submissions in for this deadline of noon on Tuesday, really should get the committee's full consideration. One of the matters would be a thorough review of international best practice. These are complex sets of laws in every country. They have evolved over time in countries like the United Kingdom and the United States to have a certain integrity to them and a workability.

One of the things that the Australian Law Reform Commission was singularly negligent in doing in its original report in 1993 was alluding to what was best practice around the world. While it issued a supplemental report which showed that virtually all countries in the world require independent parties, such as custodians or depositories or trustees, there was hardly a mention, and in fact probably not a mention, of international practice when it came to its report and findings.

One of the things that the committee could well do would be to seek further submissions, and have time for a detailed consideration of what the regulators in the rest of the world, and the laws in the rest of the world, are, and compare them with the bill that is being put up, because at the end of the day, whatever our rules here are, they are going to be compared with those of other jurisdictions by international investors. That is one thing the committee could do.

The second thing I believe the committee could do would be to allow time for further submissions, particularly from investors, who have hardly been canvassed on this subject for many years and whose views are not really before the committee in any substance, as I understand it, in the hearings today. There are a couple of things the committee could do.

The third thing would be simply to have time to digest the multiplicity of amendments that have been proposed to a very complex piece of legislation. This is a bit like the tax laws. You pull out one section or you put one section in and you are going to create loopholes and imbalance in the whole fabric of the law. I think that more time would allow the committee to give better consideration to what is a very important piece of legislation.

Mr LEO McLEAY—I must say that one of the concerns I had when we started doing this in the last week was that we only seem to have received one submission from an ordinary investor. I have just been told there is a 100 per cent increase in that—there have been two. One of them we have here today, so we are going to hear from half of the small investors. If this committee has a role, it should be to try to protect the rights of ordinary Australians. As Mr Mansbridge said, it is not necessarily the top end of town that we should be looking to assist, but to make sure that if people are going to invest then there should be some security in it. Do any other people who have just given evidence disagree with Mr Bradley that we should have a longer time frame?

Mr Bradley—Let the record show none.

Mr LEO McLEAY—Do any of you have any other suggestions on what we should look at, other than what Mr Bradley said? Do you have any, Mr Mansbridge? The people that you represent are probably a significant group. If we are to assist in the provision of some protection there, they are the sort of people we should be interested in.

Mr Mansbridge—Certainly, as far as my people are concerned, they are not fully aware of what was happening. It did happen relatively quickly; I know it has been discussed for quite some time. Certainly, the level of investors that we have at home—they really need time to digest things. That is not disparaging, I hope, of country people, but we do tend to want to think things through, and we want to do it right and we want to do it carefully, so we do need a little bit extra time for those. I am certain, given that time, that we can make some appropriate submissions and I am sure that there will be some people who will be happy with the proposal as it is—I do not think there will be very many—and there will be quite a few that will be rather upset. I think it is very appropriate the committee ask to hear those people.

Ms Kelly—A detailed analysis of the differences between the SIS legislation and the bill would be of great benefit to the committee, also a really good look at the ISC arrangements which exist to underpin SIS. I would also recommend consideration of Mr Dwyer's submission to the committee, looking particularly at the economic theory and the rationale which may or may not be underpinning the bill. I would suggest that some additional time would be beneficial in those areas.

Mr Bradley—If I may just add to my comments, it is often said that this bill is just following the public offer superannuation model under SIS which has been a highly successful model in place for three years. I would recommend the committee review the reports by the Insurance and Superannuation Commission on the very poor quality of compliance that they found in their audits of the public offer superannuation funds in this country about 12 months ago. They have put out an extensive report and it will reveal matters that will be of great concern to this committee and to the parliament about whether the public offer superannuation industry is properly regulated and complying.

Mr LEO McLEAY—I just have one further question, Mr Chairman, that Mr Bradley, Ms Kelly, or someone else, may wish to answer. I was quite concerned when I read the critique of this bill by Standard and Poor's where in one particular area they say that the bill offers a lower level of investor protection than the regime that applies to public offer superannuation entities. They then go on to talk about how this bill moves away from world best practice. Would you be able to give us a brief outline of what are the situations with trustees in, say, the UK and the US? I have got to go a division but I am sure my colleagues will be very interested in the answers that you give.

Mr Bradley—Chairman, is it appropriate to respond to the question?

CHAIR—What is happening in regard to the answer to Mr McLeay's question?

Senator CONROY—We will wait until he gets back.

CHAIR—Fine. In relation to the time frame for consideration of the legislation, isn't it true that there has been quite substantial consultation on this bill by both of the parliamentary secretaries that have been responsible for it—the previous parliamentary secretary and the current parliamentary secretary—extending over nearly two years and that the bill itself has been in the public arena for quite some time. So in terms of your submissions to us, isn't it reasonable to say that they would follow basically the same sort of material that you have put to the government previously in relation to this bill and in the consultations that you had with them?

Mr Bradley—Chairman, an immense amount of material has been submitted over many years on this bill but, as I sought to say in my opening address, if you take one leg of a three-legged stool out, then you no longer have a stool. This is the case with this bill; it has to be looked at it in its entirety. We saw the current bill with its amendments and changes since the 1995 exposure draft for the first time on 3 December last year. There really has not been a wide industry consultation on the bill that emerged on 3 December.

Proceedings suspended from 10.52 a.m. to 11.01 a.m.

CHAIR—We can resume, gentlemen. My apologies for that interruption. We might proceed with Senator Murray's question.

Senator MURRAY—It is evident that you not only see serious weaknesses in this bill but are probably opposed to it in principle and amending it is probably your second best option. If that is so, though, you should be able to tell us whether there are any aspects of the present system which you regard as seriously flawed and would be worthy of improvement.

Mr Bradley—I am pleased to have the question, Senator. The preoccupation with this draft bill over the last three or four years has not given many of us a reason to seek to formulate precisely what, if anything, is needed to improve the current system. Our submission to the government after the 1995 draft bill was released simply suggested that, because of the alleged confusion of roles, it would be sensible to incorporate in the current law a statutory definition of roles or to require a statement of the respective roles of manager and trustee to be published in each prospectus so that investors would be very clear about whom they turn to and look to for their protections.

Those are very relatively small amendments. A similar set of amendments was framed in draft legislation in New Zealand last year. It perhaps might be of interest to the committee to review how that jurisdiction framed draft legislation to overcome that particular issue. I would be happy to table that as a supplementary submission if you would be interested in it.

We also think that there are a number of weaknesses in the current law that go to reduce the power of investors to look after their own affairs. For example, there is no requirement in the current law that there be an annual meeting of the investors in a managed fund. Some of the managed funds we are now talking about have billions of dollars in them and are listed on the Stock Exchange and would be among Australia's top 30 or 40 companies. Nevertheless, they are not even required to have an annual meeting where the investors can query the managers of those funds—as shareholders would the board of directors of companies—on the performance of those funds. Therefore, we think a requirement for annual

meetings would be an improvement over the current arrangements. In a similar vein, the takeover laws do not apply to unit trusts. We have had situations in the last year or two where major managed funds have been bought by other managed funds and the investors have not had the protections that apply, for example, to minority shareholders under the takeover laws. So there are a number of those sorts of improvements, but I would have to say very few of them have received much attention in view of the thrust of this legislation over the last few years, though some of those are embodied in some of the submissions before this committee, including the one by the Australian Shareholders Association.

Senator MURRAY—What is the present role of the ASC with regard to the present system?

Mr Bradley—I might need some help on this one. The ASC has, we believe, adequate powers to supervise the industry under the current laws. It has to approve trust deeds before you can float a trust. It has to approve trustees. It has criteria for whom it will approve as a trustee. It used to be the practice of the ASC to conduct actual surveillance visits of trustees, although I understand these were discontinued in the last 12 months because of budgetary constraints.

Senator MURRAY—Is that unwise?

Mr Bradley—It is a departure from previous practice and is in stark contrast with the level of surveillance, for example, which persists under the Insurance and Superannuation Commission.

Senator MURRAY—Is it too simplistic a summary to say that the new system would move from a tripartite regulatory system—trustees, external regulator, namely the ASC, and fund managers—to a bipartite system?

Mr Bradley—I think that is exactly the effect of it, because the so-called independent directors who are supposed to take the role of the trustees are very different in their liabilities and answerabilities to the investors. They are not directly suable by them. They are not appointed by them. They can be removed without reference to them. They are not paid by them. They are paid by the fund manager, the responsible entity itself, and yet they are supposed to wear two hats and regulate themselves. So in many respects, I think your characterisation is an accurate one.

Mr Mansbridge—I would like to add a comment. In relation to the surveillance of trustee companies by the ASC—and I have been in the industry for quite a while—I have noticed, pre-Estate Mortgage and those situations, that there was not really any surveillance as far as assessing whether a trustee company had sufficient resources in terms of personnel, computer, or previous experience to a large extent. It certainly has changed dramatically—I know that has now been put on hold—but we were getting very regular visits and they would assess the number of personnel we had. Every time we needed a new trust, they would assess our capacity to do it in terms of personnel, computers, management and directors.

When that was happening, you had a situation where the ASC was looking after a relatively small number of trustees, which they could do reasonably efficiently. Trustees were then also looking after fund managers. We have now taken the trustees away. There-

fore, you have got the ASC looking at Kingower and small places like that where we have our trusts. How are they going to come up to do that?

Senator MURRAY—There is no guarantee, is there, Mr Mansbridge, that the budgetary constraints on the ASC will not be maintained?

Mr Mansbridge—That is right. That is just a physical impossibility.

Senator MURRAY—This is my last question because of the time constraint. I will not tell you how I arrive at the percentage, but I have a four per cent rule. Essentially, my view is that we legislate for the four per cent who are miscreants or potential miscreants in our society, which would mean four per cent of trustees could be rogues, or four per cent of fund managers, four per cent of priests, four per cent of politicians, whomever you want to put in that category. The effect is that at present you have trustees who are opposed under the separation of powers and no conflict of interest process to fund managers. On the four per cent rule, it may be unlikely that you would coincide with the four per cent of fund managers and the four per cent of trustees at one and the same time, which produces a safeguard and narrows the possibility of fraud and people running off with other people's money.

You have trotted the billions very easily off your tongue, I have noted, and the scale of funds which you manage is enormous. But I think Mr Mansbridge brought it back home to us all that it is really mum and dad's nest egg, their future, their retirement possibilities that we are dealing with here, and that is an extremely serious issue. So it behoves us to be very careful of any situation which would create a much greater degree of risk to the battlers, to the mums and dads of our society. Do you consider that the risk of those people losing their money will be greater under this bill than under the present system? Are you able to quantify that in any way?

Mr Mansbridge—Chairman, from my personal point of view, having been around mums and dads forever I basically see a situation at the moment where, if the ASC do put their resources back into closely supervising trustee companies, you will then have an independent body which is being paid for by the mums and dads—a very minor amount of money. So you have all those trustees with their resources checking up on all those people all the time, which we are already doing. It involves jumping in the car and going to the winery up in the back blocks. I cannot really see the ASC doing that, with all due respect—they may say they will. You really have to be hands on. When that money comes in, you have to be sure it is going to be invested in that winery or that share trust, or in the reafforestation, whatever it is going to be. We have not really got much certainty about that.

My personal opinion is that first of all the fund manager went down in Estate Mortgage. I believe the trustee was not really doing his role and I do not believe, with all due respect, that the ASC was doing its role. If the ASC had been watching, had looked after the trustee and made sure the trustee had the computer, the resources, and gone through the process as they should have, they would have forced the trustee to ensure that they were doing it. There are a lot more criteria on us. The ASC work with us—and I only speak about Melbourne office. They push us pretty hard and make certain we are doing the right thing all the time.

We trustees come from a compliance point of view. We understand what compliance is and we know we have got to meet time schedules. If fund managers have vignerons or afforestation—maybe it is not so applicable to share managers—time criteria and compliance is not really their role. They are out selling. They want to get things going. That is their view of life and they have to put this compliance thing, which they now control and do not particularly want, over and above them. It is a peripheral issue to them; whereas, our main issue is to make certain that we do the right thing and the right things happen. That is where I see the difference.

Mr Murray—Can you add anything, Mr Bradley?

Mr Bradley—It is instructive to look at the history of why we have compulsory trustees. It was not the compulsory rule before 1955 when it was introduced in Victoria after a series of forestry scams where people, particularly returned servicemen, put their money into forestry when radiata pine plantations were first starting and found that after a few years the trees had died, that they did not own the land and in fact they had nothing for their money.

It was the wisdom of the Victorian parliament, after a law reform review committee there, that decided it was in the interests of all investors, small and large, that there be a mandatory requirement to have a trustee to hold the assets and supervise compliance. It was then taken up in 1961, without much debate around the country, in the uniform Companies Act of 1961. It was assumed in all the parliaments that this was a wise idea. Besides, it followed what was being done in the United Kingdom and in other countries. I think we are going to forget those lessons for small investors if we throw overboard all of that accumulated wisdom.

Senator CONROY—On page 2 his submission, Mr Davis talks about the types of mismanagement currently picked up which potentially would not be. Are there any examples that you could give to verify, particularly in the area of related party transactions, overcharging of fees, inappropriate expenses charged to the fund and real property dealings that are not transparent? I appreciate there might be some confidentialities, but could you give us some general examples of how those things could occur under the proposed system?

Mr Bradley—There are a number of those examples in the confidential submission which I tabled earlier on. Let me just use one or two of the examples: a related party transaction. One of the jobs of a trustee is to make sure that when a property fund manager seeks to buy a property they engage a truly independent valuer to decide they are buying at the right price.

My company had an occasion recently where we discovered that a property fund manager wished to buy a property next door to its existing property—which is a normal thing because they want to develop later—but what we discovered was that the property was being sold to the trust at a 30 per cent price increase to what it had been exchanged hands only three months before. That put us immediately on notice that there was something that needed to be looked into. When we looked into it, we found that an employee of the fund manager was, in fact, a part owner of the property and had bought it three months before and was now seeking to sell it at a 30 per cent increase in price into the fund. Was there any inside information involved? We could not know, but what we could do was require an

independent valuation by another valuer, which we did. As a result, the transaction never went ahead.

That is a little real live example of the kinds of things that a trustee needs to be vigilant about. If we had failed to detect that or act on the face of the evidence—namely, that the property had gone up 30 per cent in three months—an investor in that fund could have turned around and sued us for being less than vigilant and diligent in the carrying out of our protective role. So there is a little real live example for you that I hope will help you.

CHAIR—Do members of the Trustee Corporations Association operate cash common funds under a single entity?

Mr Bradley—Some of the members do.

CHAIR—Would you be able to give me an idea of how many single entity cash common funds are operated by TCA members?

Mr Bradley—Almost all trustee companies operate trustee common funds, including common funds that manage cash. There is a distinction between funds that are offered to the public and ones that are simply a pooling of the internal moneys held under individual trusts. Most common funds that are run by trustee companies are authorised for us to pool the resources of deceased estates, for example, or of individuals whose money we are holding under individual trusts—charitable foundations and the like—so that that can be more efficiently invested. We keep a segregation of the ownership of that under our accounts, as we have to, because it is all held under individual and separate trusts. So the vast majority of trustee common fund moneys are a pooling of moneys held under individual trusts of that kind. A small percentage of them are offered to the public.

CHAIR—But they, nevertheless, are investor funds.

Mr Bradley—That is correct.

CHAIR—They are not the trust's own fund, are they?

Mr Bradley—No. They are all owned by the investors. I think the committee should be aware that, as far as I know, there has never been a loss on a trustee common fund in the history of Australia.

CHAIR—But you can see that there is some inconsistency in your submission—you are arguing strongly against a single entity approach yet you do operate that yourself in relation to cash management.

Mr Bradley—The common funds have been granted an exemption after an extensive review by the ASC because of the inherent differences between a trustee common fund and a public offer managed fund. Amongst those differences are, firstly, the fact that it already has a trustee that is regulated under state trustee laws, that has to have capital requirements and that is prudentially regulated effectively under state law. Secondly, there is a trustee duty of care established between the trustee and the individual investor. It would be impractical to

have two trustees with the identical discretion and responsibilities. That is not the case with a managed fund, where the manager has a set of responsibilities and the trustee has a separate supervisory set of responsibilities.

The ASC has accepted those differences, but it has not exempted trustee common funds if they are offered to the public from the prospectus requirements and the requirement to lodge an authorised deed. To the extent practical for a very different legal creature, we have operated for many years under a regime which brings those funds where they are offered to the public as close as possible to the existing system.

Mr Mansbridge—We also have a very small cash common fund, but the situation is that within Victoria we are restricted by legislation as to what we can invest. It is very clear what we can invest by legislation under the Trustee Companies Act. That same Trustee Companies Act also states that, if any director of a trustee company is knowingly aware that there is an investment made of trust moneys which is contrary to the law, our personal assets are liable—mine. It also extends to the managers and they are not too sure how far it goes down in our officers' line. It is a very serious thing and I know Jan Wade said, 'Who on earth would want to be a trustee company director?' It is a very serious obligation which relates back to you. We do have constant inspections, reporting and a separate registration, but it is, as they say, an exemption the ASC at this stage has given us.

CHAIR—Is it true that the ratio of capital to assets under trusteeship is approximately 0.02 per cent—about $175 million to $80 billion?

Mr Bradley—I would have to provide a supplementary answer to that to check the figures, but I think what needs to be taken into account in the equation is that all trustee companies who operate as trustees of managed funds have very substantial professional indemnity insurance in addition to their shareholders' funds and in addition to the full extent of the assets of their directors, as Mr Mansbridge's response in relation to the state trustee laws indicates. So the full pool of capital resources that are available to back up the obligations of trustees goes well beyond the shareholders' funds. In the case of my own company, we have over $120 million in shareholders' funds and assets. We have a company that has a net worth capitalisation of $400 million on the stock market and we also have very substantial professional indemnity and directors and officers' liability insurance running into hundreds of millions.

CHAIR—But you do advocate a capital-assets ratio for managed funds of 0.25 per cent, don't you, which is about 10 times higher than your own situation?

Mr Bradley—Not if you take into account all of the additional insurance resources, no.

Senator COONEY—You have spoken about a concept rather than the evidence at this stage. You have compared it to the separation of powers at government levels and said that the separation of powers creates a creative tension, I suppose. Could you just develop that a bit more? In answering a question from Senator Murray, you said that people can sue the trustee company, which you probably know is a very awkward way of going around enforcing your rights. Is there also a creative tension between the management company and the trustee company?

Mr Bradley—Yes. I think creative tension is one way to put it. There is a mutuality of interest, but there is also a situation a bit like the relationship between a Prime Minister and a Governor-General. The Prime Minister effectively recommends and appoints the Governor-General, but then the Governor-General can sack the Prime Minister. So I think it is a bit like that. We see that many times both in politics and in business. We are selected by a fund manager to take on the trustee role but, having been appointed, we are then paid by the investors and we are their representative and we have to look after their interests and unequivocally so. There is no conflict of interest in that.

Senator COONEY—I can follow that, but then the ASC's part, you were mentioning them before and I am just wondering how far it is reasonable to rely on the ASC to provide a protection in this area. They have a wide range of duties and a limited amount of income, so that when we are assessing the position of a trustee company and a management company and the whole system, are we putting too much onus upon the ASC to play a part in this? When I say 'a part', of course they have got to play a part, but are we expecting them to play too great a part?

Mr Bradley—We believe the bill would have that effect. We have the situation at the moment where we believe the ASC has ample powers to do its job properly. There has been a significant improvement since the 1980s in terms of the effectiveness of the ASC and its operations until recent budget cuts, and we think that structure will work well.

If I could just give you an example of the kinds of things which are very difficult for the ASC to do which we can do because we are private regulators. When someone wants to float a managed fund, they have to find a trustee that is prepared to effectively put its capital on the line to ensure that they will comply. If we have any doubts about the integrity of the promoters or their financial capacity and ability to live up to the promises they have in their draft prospectus or if we feel there is something suspicious about the nature of the assets they are going to invest in, we have the ability to say, 'No, we're not prepared to take you on,' or we will require them to get some directors that have better credentials to carry out the scheme. We as an industry can always exchange notes with each other. We have a long institutional memory about people that can and cannot do these things.

That is not a power that the ASC could exercise. It would have to have clear objective rules that could be challenged in the Administrative Appeals Tribunal and the like if it is going to discriminate between one promoter of a scheme and another when it licences. That is just an example of our way of protecting the investors in those situations. Our capital is on the line. Our actual funds and my house are on the line for making a good judgement about who we will back. That is one of the differences, and I think it is quite a good example.

Senator COONEY—What about having in the system of checks and balances the ability for a small investor to sue? That is not a real choice for that small investor because of the difference in the ability of a company to finance litigation and the ability of a small investor to finance litigation.

Mr Bradley—It is not a realistic protection. We do not put it up as that. It is just a symbol of the fact that the trustee is under an obligation to sue or to take any other action it must to protect the interests and assets of the investors. If it fails to do so, it gets sued. It is

not realistic to expect ordinary investors to begin litigation on their own. The risks and costs are far too great, even for large investors, to seek to enforce their actions through the courts. That is what is going to fall out of the system under this bill.

Mr Mansbridge—I want to make a very brief comment about the previous question. I would hate for the impression to be created that the fund managers and the trustees are always opposing each other. We have different views today to some of the fund managers in relation to this particular aspect, but the day-to-day relationship is really more a partnership. The responsible fund managers appreciate it if we find something that they are not doing correctly, and they immediately fix it. The majority of them are good. There are a few that need to be brought into line and deliberately try to flout it. We watch and we come down hard on those. It is a relationship; it is a partnership. That is the way we look at the majority of them, but we are watching just in case.

Senator COONEY—Could you explain that a bit more. I am sure you do not want to create this impression, but the impression that may be created from that answer is that really there is a comity between the two. If you are going to eliminate any sort of tension completely, then people might say, 'What is the point of having a trustee management approach?'

Mr Mansbridge—Fundamentally, as with most Australians, most fund managers want to do the right thing. As I mentioned previously, most of them are entrepreneurial people who are out there selling and dealing in shares, getting involved in equities and doing those types of things. That is the nature of those people. Our nature is more compliance, in making certain that the rules are applied and that the trustee is covered.

I know of a situation where a fund manager came along and they had bought some gold futures as in an equity trust because they believed that gold was going to go up and they were going to buy some shares. They had all the reasons why it would be. It did not really fit in with the trustee, so we had to say to them, 'Sorry, that just doesn't work.' They were not upset about that. They accepted that. They were pleased that we brought those things to their attention. That happens virtually every week. We are very small, but there is always some little thing to raise. They will come and talk to us about things before it happens, so you develop a relationship with them.

Senator COONEY—Are you saying that, even though there is this check the whole time, that check can be carried out in an affable way? Is that what you are saying?

Mr Mansbridge—Yes, in the majority of cases, sure.

Mrs JOHNSTON—I would like to ask a few questions in regard to the superannuation funds. Mr Bradley, can you tell me how many TCA members operate superannuation funds under SIS? How many of these are public offer schemes?

Mr Bradley—Again, I would not be able to provide you with any accurate statistics. It is not something we have surveyed. Several of the companies would. In the case of my own company, we offer public offer superannuation funds.

Mrs JOHNSTON—Would those superannuation schemes use external custodians for their public offer funds?

Mr Bradley—Some of them do. Some that have adequate capitalisation are not required to do so, so they do not.

Mrs JOHNSTON—If I took a company such as Perpetual Trustees Australia, which is a subsidiary, as you well know, of the largest corporate trustee, I understand that they do not use a custodian for their public offer superannuation funds. Is that correct?

Mr Bradley—Yes. Perpetual has a small public offer fund. Since we have all the capabilities internally, are regulated and have adequate capital, we have chosen not to use an external custodian. We provide custodian services for 45 per cent of the Australian managed funds industry, so we have all the established systems to do that.

Mrs JOHNSTON—Why would you then say in your submission that it is absolutely vital that companies do have custodians, given that you have just agreed that some of them do not? I think the emphasis should be on the word ‘vital’.

Mr Bradley—I think it is vital because of the large differences that exist between the liabilities and regulations of a statutory trustee company and those that will apply to a fund manager under the Managed Investments Bill. As Mr Mansbridge pointed out, under the Trustee Corporations Act, every director is personally liable for every trust to the full extent of their personal assets. We have a requirement for minimum capitalisation. We have the ASC approving us. We have the ISC approving us. We have frequent visits from the ISC to survey every aspect of our operation. There is a regime of prudential control there which will be missing under this bill.

Mrs JOHNSTON—I also want to mention some of your media releases, and this is with regard to costs and savings. On 2 March you put out a media release which said that, under this legislation, it would cost approximately $40 million a year, and I think you got that from a KPMG study. Yet the Price Waterhouse study for IFSA puts costs savings to funds at approximately $90 million a year after allowing for increased custody and a compliance cost. Can you give me some explanation as to what happens to the $60 million in between?

Mr Bradley—I am unaware of the Price Waterhouse report. It has never been brought to my attention.

Mrs JOHNSTON—You have not seen it?

Mr Bradley—I have never seen it. I do not know it.

Ms Kelly—It has not been made available to us and we have never seen it.

Mr Bradley—Nor have I read any media coverage of it.

Mrs JOHNSTON—It would be interesting if you could. Do you think that there could be savings achieved under this legislation? I know that Ms Kelly has suggested to me that it would be very difficult.

Mr Bradley—It is possible that some very large fund managers may see themselves as being able to make savings. It will depend upon what additional costs they put in place to ensure proper compliance, to take over the back office, settlement services and the like that are provided by the trustees currently. It is impossible for us to have a view on that. The KPMG study has establish that, for the large majority of fund managers, particularly the medium and small size fund managers, there will be a substantial additional cost. One of the submissions before this committee from Mr Crivelli, who is operating as a small fund manager, has indicated that his costs will increase fivefold.

Mr Mansbridge—I know they talk big numbers, but if you bring it down to individual investors—how much is that person prepared to pay to protect his money?—it is very small. The numbers for individual investors are very small.

CHAIR—Perhaps you may answer Mr McLeay's question which was deferred in his absence. We must then wind up at that stage because we are going well over time.

Mr Bradley—In view of the time, one way for me to contribute to Mr McLeay's question would be to table three documents as supplementary exhibits. The first is the Australian Law Reform Commission's comparison of Australian laws with the United States, Europe and the United Kingdom. The second is a detailed comparison of the Australian and the United States regulations of the US Mutual Fund Industry prepared by Arthur Robinson and Hedderwicks dated 29 July 1996. The third is the Securities and Investment Board's rules on the regulation of open-ended investment companies in the United Kingdom.

I want to say a word about this. The United Kingdom looked at this whole issue of whether the unit trust structure with the manager and trustee was out of date a couple of years ago. There were submissions to abolish trustees in the United Kingdom. Rather than abolishing trustees, the United Kingdom in fact strengthened the role of trustees under their regulations. At the same time they created a second alternative vehicle for investors to use called an open-ended investment company which is basically where you invest in a company rather than in a unit trust.

Although that was a company, they nevertheless required that the company's assets be held by an independent custodian, which they called a depository. They set out in the law extensively the supervisory responsibilities of that custodian or depository. That is why I table that third document which is the regulations of 1997 that govern the conduct of that scheme. Those three documents, if more time were permitted, would enable me to more expansively explain to you how the other systems work. But, suffice it to say, almost all the British Commonwealth countries—including our Asian neighbours like Hong Kong, Malaysia and even non-British countries like Japan, Indonesia and Thailand—all require independent trustees or custodians if you want to offer mutual funds or unit trusts to the public.

In the United States there is a tripartite system of support. Firstly, each mutual fund is itself a company with directors elected by the investors and accountable to them. Secondly,

there will be an independent fund manager engaged by that company. Thirdly, there will be an independent custodian required in almost all cases under the US law. In the relatively few cases where it is not required to have an independent custodian under the US law, as I think is outlined in Dr Dwyer's paper to the committee, there is a requirement that all the assets be held by a bank and that there be an audit inspection of them three times a year, twice without notice to the entity. They are extraordinary protections which are much stronger than will be present under the Managed Investments Bill.

CHAIR—I thank all of you for appearing before the committee this morning for the evidence you have given and your answers to questions. Thank you.

Mr LEO McLEAY—Mr Chairman, could I thank Mr Bradley for what he has just provided. What Mr Bradley and the other witnesses have said so far today shows just how difficult it will be for us to complete this inquiry and report in 11 days time. I would foreshadow that later on today I will be proposing that the committee seek an extension of our reporting date to the Senate.

CHAIR—Thank you, Mr McLeay. Before you leave, I must formally accept those documents offered by Mr Bradley. Are there any objections? There being no objection, it is so ordered.

Mr LEO McLEAY—Thank you, Mr Chairman.

[11.38 a.m.]

DWYER, Mrs Deborah, Partner, Dwyer Partners, 11 Sheehan Street, Pearce, Australian Capital Territory 2607

DWYER, Dr Terry, Partner, Dwyer Partners, 11 Sheehan Street, Pearce, Australian Capital Territory 2607

LAMBLE, Mr Reginald John, 6 Oak Hill Close, St. Ives, New South Wales 2075

SWEENEY, Mr John, Chairman, Trust Company of Australia Ltd, 80-84 New South Head, Edgecliff, New South Wales 2027

WARNER, Mr Ian, Senior Consultant, Jackson McDonald, 81 St George's Terrace, Perth, Western Australia 6000

CHAIR—I welcome Mr John Sweeney, Mr John Lamble, Mr Ian Warner, Mr Terry Dwyer and Mrs Deborah Dwyer. For the *Hansard* record, would each of you please give your names and the capacity in which you are appearing before the committee today.

Mr Sweeney—I am Chairman of Trust Company of Australia Ltd.

Mr Lamble—I have come in a private capacity as an investor, though I declare my interest as Chairman for Perpetual Trustees. You can qualify anything I say on that basis.

Mr Warner—Although my submission is through Jackson McDonald, my law firm, the submission is not to be taken as a Jackson McDonald submission; it is to be taken as my submission as an experienced trustee company director.

Dr Dwyer—On behalf of Mrs Dwyer, we appear here on our own behalf.

CHAIR—Unfortunately, we can give each of you only a limited time to address the committee. Each of you will have that opportunity, but I think you have been asked to keep your comments reasonably brief. As we are now running considerably over time, I can only reinforce that.

Mr Sweeney—I am aware of the shortness of time and, naturally, I will keep my comments as brief as possible. I would like to thank you for the opportunity to appear here. I would like my submission to be read into evidence, if that is possible.

CHAIR—Read into evidence by you or incorporated?

Mr Sweeney—Incorporated.

CHAIR—There being no objection, the submission will be incorporated in a separate volume.

Mr Sweeney—There are a number of matters which I think I should elaborate on. Firstly, it is terribly important for members of this committee to be aware that a statutory trustee company is under the onerous restrictions of the trustee acts and the trustee companies acts of the various states in which it operates. I have for some time been amazed why some of the fund managers have not taken the opportunity to become trustee companies because the trustee industry would not object to that and would welcome the fact that the fund managers would be under the same requirement.

Secondly, you will hear later on from the funds management industry—and, indeed, this has been mentioned in the paper—about trustees not allowing their names or any responsibility in prospectuses. There is a very clear and solid reason for that. Trustee companies are supposed to implement the activity of the fund manager as a result of a trust deed and the prospectus that has been issued. The trust deed cannot be part of the prospectus because there would be a conflict of interest. The prospectus is the manager's document, spelling out what he is going to do, how he is going to do it and all the things he is going to do for investors. It is the trustee's job to see that he does just that and sticks to what he says in the prospectus. There have been a number of occasions where managers have not stuck to the prospectus.

Thirdly, have we thought through what will happen if this bill goes through in its existing form and it is a failure. Let us see the scenario that we have got then. We have got the trustee industry without its activity. One trustee company has said it will dismiss 300 people. Its corporate trust sections have been disbanded and suddenly you get the system not working. What do we do then? What does the poor private individual investor do then? What does parliament do then, because it will have passed a bill that has created the situation? I suggest that the only reasonable thing that can be done is to let the two systems run in coexistence for a period of time until such time as there is competition in the market and a comparison of how the two systems go with regard to costs can be made.

In the existing bill it is stated that the system will be revisited in two years. Why do we not have the coexistence system, which I have put in my submission as alternative two, and then examine it in two years? It seems to me to be a most sensible suggestion. I do not say that just because I made it, but that does not detract from it I hope.

Finally, I would like to point out the administrative problems that will be confronted if the new bill goes through. You are going to have three organisations: the compliance committee, the independent auditor and the ASC. Three organisations disparate, not talking to each other, doing the role that one organisation did before—the trustee. Mr Chairman, I think I have spoken long enough. I hope you have taken my points. Thank you very much indeed.

CHAIR—Thank you, Mr Sweeney.

Mr Lamble—I am here as an investor. I would ask that the submission that I have written to you is incorporated into the record.

CHAIR—There being no objection, the submission is incorporated in a separate volume.

Mr Lamble—I believe your committee must devote itself to the four per cent that Senator Murray mentioned. It is only a small proportion that have caused trouble in the past, and they will in the future. Unfortunately, I will not be here to hear the fund managers make their submission, but I am quite sure that none of those, if they were a racehorse, were by Bond out of Skase. You will not have in front of you any of the scallywags. That is what you really have to devote your mind to. You are not hearing from the people who will cause trouble in the future. I have been an investor for 50 years and I see cycle after cycle. You never get trouble at this time in the cycle. It will be when there is a collapse that there will be trouble.

So I do think that is your problem. I do not see how there is any improvement in the sieve, if you like, that is proposed by this bill. For example, take Metro Growth Property Trust, one which I had a very close association with in terms of representing an investor. In terms of a compliance plan, all of these proposals would have had done absolutely nothing in that case. If you look at any of the major collapses from equity, metro growth and retail property trusts—there have been a number of them—I believe that in not one of them was the manager available. I make the point in my submission that, when we sued the manager of the Metro Growth Property Trust, he put himself into liquidation within 14 days. That company was owned by a substantial fund manager who is still in the business today. The fact that they had a very sizeable parent did absolutely nothing for the investors.

It is not so much those; it is the unknowns, the glamorous idea that will be put forward. I do not believe that the nature of a regulator can make that sieve so tight to keep them out. They really cannot say to someone, 'You can't be a director.' With my work on advising on the Insurance Act we looked at having fit and proper persons for directors. It, frankly, does not work because you cannot stop someone from having an occupation. That I think is the real problem.

The second one is that the compliance plan is not real time. Take Equity Mortgage, they got all their records in a muddle and they did not know which mortgage belonged to what trust. A compliance plan is after the event. It will not fix that problem. I summarise by saying that I think your focus must be on the four per cent. I do not believe you have had any submission from them.

CHAIR—Thanks, Mr Lamble.

Mr Warner—Mr Chairman, I ask that my submission on Jackson McDonald notepaper be accepted as my submission. One thing I can say with certainty is that, if this bill is passed, it will be a wonderful bonanza for my profession, the legal profession, not only in the enormous amount of work that would be required to bring organisations to be compliant with this act but also in the many disputes that will arise when fair weather turns to foul weather. I think the principal problem with this act is that it is fine in fair weather but not in foul weather, which is another way of saying that it is the four per cent problem that one really has to deal with.

A lot has been made that there was confusion in the roles of trustee and manager. There certainly was some confusion when the balloon went up on a very small number of trusts—we are only talking about less than five, I would say—and in none of those cases was it

required that a Supreme Court finally define what the roles of the two entities were. In all cases, ultimately, a compromise was reached. I am not suggesting that does not mean to say there is room for improvement. What I am saying is that it was not so far out and so in dispute that it could only be resolved by a Supreme Court.

One other problem that the bill has is assets being held separately for identification purposes but, nevertheless, being held by the same entity. That is a fundamental problem—a fundamental weakness. It flies in the face of hundreds of years of trust practice. I invite you to consider carefully the Barings case, for the Barings case is very important in the consideration of the pros and cons of this bill.

Senator MURRAY—Sorry, is that itemised in your submission?

Mr Warner—Yes, it is. I could talk about it now, but it is just going to detract—

Senator MURRAY—I just want the reference.

Mr Warner—It is definitely described there, and I do recommend that, if you can, you read the report of the Bank of England on the Barings case because it is very instructive on this whole problem.

The bill also refers to a board of directors who are independent, or half of them are independent. What does that mean about the other half? Quite frankly, all directors ought to be independent. What independence means in the board context, quite frankly I do not know, because I have seen in my experience so many men who are supposed to have been independent, but when their real interests seem to be impugned upon it is amazing the way they can justify themselves. I will not take that one any further. In summary, because—

Senator COONEY—It might be an interesting one to take further.

CHAIR—Especially when you are looking at this lot.

Mr Warner—Mr Chairman, lady and gentlemen, to really try to get it into a nutshell I have used the same words as John Lamble: real time. There are two advantages of the present system. One is the advantage of checking before the event. There are so many situations where the trustee companies of Australia have stopped problems arising. You do not know anything about it, nor does the general public, because they did not become problems. They were not problems—they were prevented. Graham Bradley, probably in his confidential submission, will go into some detail on that.

It is an extremely important point, and this is where the regulator just cannot do it; it is just not in his function. The trustee companies have had a long experience of stopping things and of course causing a fair bit of irritation amongst the highest and the mightiest of this land, but have proved to be correct. Again, I refer you to the Barings case because it is very important in that particular context. It is very important to know that even the mightiest, the Bank of England itself, criticised itself on Barings, and likewise Coopers and Lybrand.

The second great advantage of the present system is that if the checker, namely the trustee company, makes a mistake—and trustee companies do make mistakes I have got to confess; trustee companies are not God, any more than any other institution is—then the great advantage of the trustee company is that it is worth suing. It does have deep pockets. That really is an enormously important point for your committee to consider. The few failures of the trustee industry, notably, say, Aust-Wide and Permanent, demonstrate that the trustee system does work, because no matter what system you have, you are always going to have some major malfunction of the system. The important thing is to have a system that can take proper remedial action in the event of a malfunction. That is the second point, which is enormously important.

In relation to superannuation, the jury is still out on superannuation. After all, it was only 1994. We have had no economic downturn of any consequence since 1994. Mr Bradley has referred you to reports in relation to the supervision of superannuation funds. That is very important for you to look at.

CHAIR—Mr Warner, can I ask you to bring your remarks to a close?

Mr Warner—Yes. I will just conclude by saying the simple solution. I am a very simple person. I do not understand all these problems that go over my head. The simple solution is that you should look at the present section 1069(1)(a) to (n) of the Corporations Law, which basically sets out the roles of the manager and trustee. There may be room to better delineate. There is not a huge amount of work to be done, but you should look at section 1069(1)(a) to (n). There may be some subsections that need to be modified or added but that is the simple and effective solution to this problem.

CHAIR—Thank you very much, Mr Warner.

Dr Dwyer—Mr Chairman, could I hand up a revised copy of our submission with a disk and ask that it be incorporated into the record?

CHAIR—There being no objection, it is so ordered. The submission will be included in a separate volume.

Dr Dwyer—Rather than taking the committee through the whole submission, since it will be in the record, I would like to approach this from a somewhat different perspective, as an economist, and that is: why do we worry about savings or investment at all? The reason we worry is that without investment we do not have capital formation, we do not have rising standards of living and we have economies that fall apart. Albania and Indonesia are two cases in point at the moment. When you have a collapse of confidence in your economy or your regulatory system, the international markets can exact a very heavy price on your people.

The area which has struck me in looking at this bill is the extraordinary lack of discussion on international competitiveness. Here we are in Australia signing treaties, such as the World Trade Organisation, committing ourselves to free trade and financial services, while potentially implementing a regulatory regime that the Americans will be extremely fast to point out is substandard and below theirs, so they can market into our market their financial

services and undercut our financial service providers, increase our balance of payments deficit, while turning around and saying to us, 'You can't export to us your financial services because, just like your meat inspection system or your quarantine laws, you are substandard.'

Basically, this is going to be an issue with increasing dimensions in terms of Australia's international interests. We have seen, to our north, countries suffer from a collapse of investor confidence in international markets. If we have a system that is unacceptable to US pension fund investors or unacceptable to the US Securities and Exchange Commission—and I have attached in my submission a copy of a letter from them—then Australia's long-term reputation will sink to the level of Bolivia's in the 19th century. Once you get a bad name in financial markets—just as British capital was eaten up in South America and they paid the price for decades afterwards—once you suffer from a lack of confidence in your regulatory arrangements, then you are in trouble.

I want to point out to you that the Americans are watching this very closely. The Investment Company Institute, for example, has issued a press release on the financial services agreement. They have also issued a press release on Australia's foreign investment fund legislation from the tax point of view. At the end of the day, if you are a capital importing country like Australia, dependent on the savings of foreigners to build up your country and your standard of living, then you have to give foreigners and your own people two things: you have to give them protection for their savings, and you have to make sure they are not going to be stolen, whether by the Commissioner of Taxation or anyone else.

Reputable overseas jurisdictions which try to attract capital do pay a great deal of attention to the regulatory regime. If you look at the amount of capital that is now outside of the major metropolitan centres of London, New York and so on, you see there is competition of two kinds. There is competition to provide proper prudential regulation and competition on tax. People want security for their savings and they want low taxes. We are in an internationalising world where the pressures are going to increase. Australia looks as though it might end up with the worst of all worlds with high taxation of trusts and adverse changes to them and worse protection. The long run impact of that on our standard of living could be severe when you get the vote of no confidence from the financial markets.

I turn to another point which struck me about this bill. It is supposed to be part of a corporate law economic reform program but, in fact, it is increasing the amount of regulation by prohibiting the freedom of parties to enter into their own prudential arrangements. The competitive thing to do would be to do as some other overseas jurisdictions do and offer a choice between the traditional British units trust type system, the American investment company model or no protection models for sophisticated investors, which are not offered to the public. You maximise your sales by tailoring, as it were, a cafeteria approach to your clients.

If you are going to take an economically rational view of this—and I do not believe it is the only issue; I am a trustee of a will and I am very much aware of the personal interest—if you are going to take at a coldly detached view of maximising your attractiveness to the financial markets internationally, then you have to think very seriously about making sure that you do not have, or get, a reputation for being substandard, and not have legislation that prevents people from putting in place their own independent trustees or custodians. I will

leave my remarks there and ask my wife to speak on the differences between what is proposed here and the US system.

Mrs Dwyer—A number of comments have been made regarding comparisons between this bill and the US system of regulating and the structure of US mutual funds. The word 'mirror' has been used; that the bill is a mirror of the US system, et cetera. Just as a Volkswagon and a Porsche are both cars, you could say they are similar. They share certain comparisons on the face of it, they have wheels, doors and a roof, but if you look under the bonnet—or the hood as we say back home—you would find a rather large difference in the quality of the engine. The more specifically and closely you look, the more you will notice that the details get very different.

In the United States, yes, there is an investment company which could be called a single entity, and that company does have independent directors. However, those independent directors are extraordinarily independent. The legislation which governs the American mutual fund industry, the Investment Company Act, mandates a very stringent test as to independence, prohibiting an interested person or an affiliated person from being an independent director.

It is so easy to lose your independence under this legislation that the SEC, the Securities Exchange Commission, has recommended that boards of mutual fund companies have a majority of independent directors. If there is an improperly constituted board, you can lose your independence technically without even knowing it. If your relatives should suddenly get a job with a brokerage firm, say, that deals with your fund shares, you could lose your independence. If you lose your independence, it is possible that your decisions could be construed void, ab initio, because you have an improperly constituted board. So it is extremely important.

It is not only that. Under section 15 of the ICA, the independent directors have very specific duties, not just duties of due care and diligence. By the way, the independent directors are voted in by the shareholder investors. When the US law or any information you read about US law talks about shareholders, these are not the shareholders of the SRE, the company running the fund, these are the investors themselves. They vote and elect the directors of the fund—so there is shareholder democracy here.

The duties of the independent directors are very specific: they must, every year, ratify and approve the investment and advisory contracts; they have to look at how much the fund is paying those investment advisers; they have to ratify the distributors' contracts and how much money is going to the distributors who then distribute the shares in the investment company; and they also have to review the insurance coverage and fidelity bond coverage—which is an interesting aspect of mutual fund regulation, in that all the officers and employees of a fund who have access to securities and other assets are required to be bonded by an insurance company against larceny and embezzlement. This is a way of making sure that your four per cent of rogues do not wipe you out—and this is prescribed under the ICA's section 17.

So there are a number of mechanisms within the US system which are not present in the bill. The proposed Australian SRE is really not one in which you have an independent voice

that is responsible solely to the investors, as you do with a two-tiered situation with trustees. The compliance committee is not answerable to the investors; it is paid by the SRE. Independent directors are paid out of the fund; they are not paid by the investment advisers in the US. So there is true independence there. If there is a mirroring of the present bill and the US system, it is a very dark and somewhat shaded one.

CHAIR—Could I please ask you to bring your remarks to a close.

Mrs Dwyer—Yes. In the US, the act actually tells you who you have to have as a custodian, and Mr Bradley mentioned this. It has to be a registered bank, a registered brokerage house and, in certain, very rare circumstances, there can be self-custody, but that also has to be through a registered bank. There have to be independent auditors who check the bank three times a year—twice without notice to the fund or the fund company; they have to go in and just look. They are trying to avoid what happened in the 70s when Robert Vesco knocked off with $300 million of small investors' funds and went to Costa Rica for 20 years. Basically they had to tighten up their custody rules as a result of that. So there have been large problems that needed rectification there. They are very concerned about the custodian rules in the US and are very specific about them.

CHAIR—Thank you very much, Mrs Dwyer. Mr Warner, as a lawyer, would you agree that not prescribing a mandatory requirement for a custodian provides greater flexibility for the administration of the law and enables the regulator to table the regulatory regime to suit the circumstances of varying investment schemes?

Mr Warner—It enables the regulator to tailor a scheme, but I think the problem is that you come up against the fundamental difficulty that the regulator is going to be after the event, not before the event. The difficulty really is that it is okay to finally pin someone down and send them to gaol, but it is small comfort to the little old lady, shall I say, who has lost her $50,000 because the government is not really going to be under an obligation to repay the little old lady or the ASC.

CHAIR—You do not think that setting forth in legislation a framework for investor protection, which would be administered by the ASC, is a better approach than seeking to prescribe every possible individual circumstance that might arise?

Mr Warner—No; I do not, not unless the ASC were to adopt a role where it must approve everything, in the same way as a trustee does. In other words, unless the ASC were to assume the role that the trustee now has, then, no, because you have the fundamental problem of the bad decision being made and then the ASC following on. In very simple terms, that is the fundamental problem as I see it.

Senator CONROY—I am interested in fleshing out the information from the United States Securities and Exchange Commission. The Investment Company Act, and the rules thereunder, contains specific requirements for the safekeeping of client assets, to the extent that the proposed Australian legislation is inconsistent with those requirements—it may make it difficult. Are you asserting that that would be the case for all single responsible entities now, that none of them would comply, or just that there might be one or two that might not

comply? Or are you saying that if we adopt this regulatory regime, blanket, no-one will be able to pass that test that the Securities and Exchange Commission put on?

Dr Dwyer—I think the short answer is probably absolutely not, no-one, because there is a provision in the ICA that allows for the solicitation in the US of funds for overseas funds that meet US standards. The US investment companies are a fairly powerful lobby. They have ensured in the last 50 years that there has never been a fund allowed to market into the US. So they will preach free trade and financial services, but they will immediately invoke the protective clauses and say, 'What you're trying to sell us is substandard.' It will be just like pork, salmon, parallel importation of CDs and everything else in these trade negotiations. Mrs Genta Hawkins-Holmes—

Senator CONROY—Are you saying that that happens now; that no-one gets into that market anyway, now?

Dr Dwyer—Yes. Basically they will now find themselves obliged to go through the processes of letting us market our things to them through our SREs, but then they will immediately invoke the protective outs in the treaty to say, 'But, you're not up to our standards.' They have done it before, and this legislation will make it easy.

Under the existing system, we would be able to say, 'Hang on, our system now is superior to yours; ours is the British unit trust model.' In fact, the truth is that I prefer the British unit trust model to the US model because you still have too much too little, at times, in the way of protection. The custodian in the US model is not a fully independent custodian at times. But, basically, we could legitimately say to the US in any trade negotiations, 'Our system is superior to yours.' Under the SRE system, it would be clearly inferior.

Senator CONROY—You are saying, 'We could say to the US.' Do many of our existing companies try to enter the US market?

Dr Dwyer—I am not aware of that. As far as I know, most of the time you have tended to have it coming the other way. You have had US companies setting up here and having subsidiaries in Australia. Of course, this is a non-issue to them, because they are already in the US market.

Senator CONROY—What I am really trying to get to is: appreciating the legal points you are making, is there an effective difference in the outcome? If no-one bothers going over there now because they are going to get knocked off, it is not going to make much difference, other than the argument that it is easier to knock them off now.

Dr Dwyer—What is going to happen is that, as this treaty with trade and financial services gets under way, we will have a chance of getting in. It is going to be hard for them to refuse to let us in because, just as Tasmania, for example, is a clean, green environment for primary products, we will be able to say, 'We've got a cleaner system than yours and, although it's not the same as yours, it's better.' But if I were to start from scratch on this, I would design my legislation by actually picking up the UK and the US systems and giving investors a choice. That way they would have no argument at all. Australia is in a terrific

time zone to act between Europe and Asia and, if we have a good regulatory system, we could make a lot of money being a middleman, but we are ruling ourselves out.

Proceedings suspended from 12.13 p.m. to 12.23 p.m.

CHAIR—We will resume.

Senator MURRAY—I was interested in some of the analogies emerging from the committee. I want to offer you an analogy that we might be moving from a community watch system where you have community watch combined with a policeman, to a policeman system only. As you know, it is when the two are in tandem that you reduce your level of crime to the greatest level; whereas, when you only have the regulator, although there is some preventative action, it is difficult. Is that a useful analogy for what is happening here with the bill?

Mr Warner—With respect to my colleagues here, I think it is a useful analogy. It is a good pen picture as to how to describe it.

Mr Lamble—I believe that one of the best ways of doing things is by commercial compulsion. As trustees, we risk losing our shareholders' funds if we do not do it right; an officer of the ASC does not. The only examples where we have had pretty clean supervision by governments have been the Reserve Bank and the life and insurance commissioners. Both of those are marked by the fact that there is a substantial shareholders' funds test. You have to have a lot of money to be a bank. You have to pass the solvency test to be in insurance. There is no solvency test of managers in this case, and the commercial compulsion no longer exists. To rely only on a supervisor, in my opinion, is a recipe for disaster.

Senator MURRAY—Thank you.

Dr Dwyer—Take an example where you have a very large float. The NRMA float was I think the largest float proposed in Australian history. It collapsed because two directors of that association had to put their houses on the line and challenged, but the ASC did nothing in spite of numerous protests. If you go through the *Hansard* record and look at the questions asked in parliament about the ASC and the way those questions were answered—or not answered, as the case may be, and what was left out of the answers—then you will see that having a policeman after the event is no substitute for having someone before the event. That is why, in my submission, I have made the analogy of a solicitor drawing a will.

If you are drawing a will—and I am a trustee under a will—you make sure there is more than one person with a hand on the cheque book and you make sure that every share certificate is held in more than one name because it is no good having all the laws against fraud and having the police or the fraud squad going after somebody who has defaulted with $600,000 of the life savings of the widow and three kids you are responsible for.

I have an investment adviser advising me. He was happy and I was happy that he would make sure that a separate trust account was opened and that there were two signatories on it. You just do not put yourself in the position where you have one hand on the tiller.

Senator MURRAY—Dr Dwyer, I want to pursue an area of remarks you made earlier to Senator Conroy about the link back to Mr Sweeney's suggestion of a tandem system between which investors could choose. I think what you were saying in response to Senator Conroy is that it is very difficult to enter the US market anyway at present, that we would have a better chance under the existing system beefed up. The issue under the new system may be that investors—Australian investors of whatever kind, battlers or larger—may choose not to invest in Australia. In other words, they may regard our prudential system as poor and may choose to put their money with foreign funds because the prudential regulations of foreign countries are better. In other words, if investors are informed, we may lose major domestic opportunities because of this bill. Is that a reasonable extension of what you were saying?

Dr Dwyer—I see that as a very real risk, Senator. When you talk about adverse changes to the tax treatment of trusts, there is already a lot of nervousness out there. We have no exchange controls, and I am not in favour of them. I think at the end of the day you have to let markets work. Basically, I think that is a very real risk. The sophisticated Australian investor will say, 'Well, rather than invest in a market of $18 million, which is a stagnant market, I will go for the big international markets, the biotechnology companies in the US and so on, knowing it is a better regulated market now.'

Senator MURRAY—The last question is: does this bill therefore advantage foreign countries and foreign companies at the expense of Australian investors, Australian companies and Australian interests?

Dr Dwyer—I think the answer is ultimately yes. We are putting ourselves in an inferior marketing position, if you want to look at it that way.

Senator MURRAY—Thank you, Mr Chairman.

Senator COONEY—I wonder whether Ms Dwyer could qualify herself. She obviously has some experience of the American situation. Could you tell us in writing how she got that?

Dr Dwyer—She grew up there.

Senator COONEY—But could you give us that in writing so we can rely on it. Mr Lamble, you have been an investor for 50 years. Have you discussed this issue with other investors and, if so, was it not only your opinion but an opinion you formed in discussion with others over time?

Mr Lamble—I believe so. My particular experience, when I was Chief Executive of the NRMA, was as an investor—the largest investor in the Metro Growth Property Trust, which collapsed.

Senator COONEY—But it is not only your own knowledge?

Mr Lamble—No. The whole team of us discussed it. Other people who were investors in that trust had a similar problem, and it will not be cured by this bill.

CHAIR—Thank you to each of the witnesses for the evidence you have provided to us and for your answers to questions. If we do have any follow-up queries, we will get back in touch and seek some further responses in writing.

[12.30 p.m.]

HAWKEY, Mr Daryl, Chairman, Regulatory and Consumer Affairs Board Committee, Investment and Financial Services Association, Level 24, 44 Market Street, Sydney, New South Wales

HOWARD, Ms Kerrie, Chairman, Regulatory and Consumer Affairs Forum, Investment and Financial Services Association, Level 24, 44 Market Street, Sydney, New South Wales

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CHAIR—I apologise to you for falling behind schedule, but we will continue the hearing on this bill for part of this afternoon's session to give you adequate time to make your presentation if necessary and to answer questions. Do you wish to make an opening statement?

Ms Ralph—Yes, we do. My remarks are couched in the context that I am four days into the job of Chief Executive of IFSA. I spent 15 years in the funds management business and I also had the privilege for 3½ years of being Deputy Chair at the Australian Securities Commission. I can say that I have seen the industry from just about all sides now.

I want to thank the committee for the opportunity to attend this hearing and make some remarks today. Before I start, I think it is worthwhile to revisit the journey that we have all taken to get here, because it has been quite a long one. It was the large combined losses in the late 1980s that prompted government to undertake a thorough review of the industry at that time. In 1993, as we all know, the report of the Australian Law Reform Commission CASAC entitled *Other People's Money* was released after much consultation and debate. That report made lots of recommendations, but the key one was moving to a single responsible entity.

Over the following five years, the combined minds in the industry, investor groups and government, including the Wallis inquiry, have poured over all those recommendations and the various versions of the bill which we now have before us. Personally, I think everybody has had a fair go at having their say over the last eight years.

The arguments that you are hearing today are not new. The arguments have been debated reasonably thoroughly over the last five years. Many of the arguments that you are hearing today are emotional and, as far as money goes, it is an emotional thing. For every story that the trustees can tell of a fund manager who was not quite perfect, I could tell you a story of trustees who were not perfect; none of us are. I guess that telling stories is not really what we are about today. The fact that any problems are occurring under the existing system to me is evidence of the fact that it simply is not working. I ask you in your deliberations to

put aside emotion and consider the overwhelming and widespread support that this bill has, not to mention its robustness to have survived this long and this much scrutiny.

So why, from our point of view, is this a good bill? We believe it is a good bill because it provides a significant range of checks and balances at a reasonable cost to the investor. We believe that it puts a system in place which is preventative, because it puts the right people in charge, it ensures sound compliance procedures and it ensures the right management systems are in place. We think it is important that it removes the confusion over who is responsible and lays it squarely at the feet of the manager, acknowledging that it is commercial reality, that it is the manager who initiates and controls these schemes and, therefore, the only party truly in a position to effectively and proactively address compliance risk.

It is true that the two-tiered system goes way back to the 1950s when in the early days trustees did manage a lot of the investments. But, in today's commercial environment, to a large extent the control and the initiation of decisions happens inside the fund manager, and that is really where we should try to address where the risks are. We also think it is a good bill because it largely harmonises with the regime of SIS. I think investors already have a hard enough time dealing with the complex array of financial instruments out there in the marketplace and the more simple and consistent we can make things for them the greater the opportunity they have to understand it and to actually take an active role and participate in the system.

Finally, the bill provides for strong oversight from an external regulator. You talk about Neighbourhood Watch. We think there is a strong neighbourhood watch in this industry. It consists of investors who more and more are becoming active. It consists of financial advisers who scrutinise fund managers and funds to ensure that when they make recommendations, they are recommending good solid funds. It consists of research houses, consultants, auditors, the ASC and the media. We think that there is a pretty strong neighbourhood watch out there.

Let us now deal with the arguments about why this might be a bad bill. The first argument is that the move to a single responsible entity will somehow unleash a flood of abuse, and that either a trustee or a custodian is the only thing standing between the investor and disaster. We really believe that the problems that were caused for the investor by the absence of clear accountability has all too painfully been illustrated in the past. We believe that the success of a single responsible entity in super is working well now. Banks and insurance companies are effectively SREs. We have talked today already about trustee common funds and, yes, the ASC, through its discretions, has allowed trustee common funds to operate as a single responsible entity because it makes sense.

To suggest that investor protection is solely dependent on trustees is simplistic. Given the commercial and personal factors that drive responsible behaviour of fund managers, I think it is way too simplistic to look at that. Personally, having looked after the interests of investors for nearly 20 years, I think it is offensive to suggest that trustees somehow have a monopoly on honesty and competency.

The second argument that is often raised is that the trustees have the deep pockets, and they will be the last ones standing to look after the investors at the end of the day. Personal-

ly, I think that gives everyone a false sense of security. We have already talked again this morning about the size of the assets and the shareholders with reserves and, yes, there is some insurance that can be drawn on. It still is not enough to cover the claims when there is a large claim, and so I think it is unfair to investors to offer them that false sense of security.

The third thing is that a custodian is essential to protect the assets. Let us not forget that a bare custodian is simply a bookkeeper acting on instructions from the manager. That process adds little value to the investor. A separate custodian is one way of bookkeeping accounts and settling the investments and the assets, but we agree with the bill that it is not the only way. Once you move from more than a bare custodian and you give the custodian some discretion you get back into the realm of confused accountability. We think that that is a dangerous move. We think the existence of the custodian with some sort of scrutinising power also creates a similar sort of moral hazard where investors perceive that there is some sort of protection which, in reality, is not actually happening in true effect.

We should not forget that in all of this market forces play a very strong role. Where a manager does not have a professional custodian as an arm of his business, as is many of the cases with some of our members, of course they will outsource that function—as many of our members intend to do. Where a manager wishes to target overseas investors, they will choose to structure their business accordingly. But the flexibility that this bill provides is essential for us to cope with the myriad of commercial arrangements which exist in the marketplace and all those arrangements that we cannot even begin to think about that might exist in the marketplace tomorrow. So I think the bill correctly deals with this by giving us the flexibility and allowing market forces to determine who will appropriately outsource those sorts of functions.

Another argument is that this bill will be very costly for the industry to implement. We have only recently had the privilege of reading the KPMG report so I have to say I have difficulty in commenting in detail on it. We have surveyed our own members and asked them about their real costs and their real experiences. The Price Waterhouse survey that you mentioned talks about $19 million and that was just those managers surveyed. If you extrapolate that across the industry, we estimate the savings to be about $30 million.

Quite frankly, if the increased costs that are produced in the KPMG report are correct, either they know something about our businesses that we do not know or we are completely irrational to want to take this responsibility on, especially in this competitive environment where there is already strong pressure to reduce margins and get costs down. It would be virtually impossible for fund managers to pass these sorts of costs on. That leads me to believe that our estimates that there are in fact savings there are probably more accurate than the fact that there may some huge cost to implement this bill.

People argue that the regulator is not up to the task. I guess I am biased because up until a year ago I was deputy chair at the ASC. But the industry's view has always been that the ASC can fulfil its role under this bill. We have also always said that the ASC will need to be adequately resourced to do that. We have said that the industry is prepared to contribute similarly to the way it does under the SIS levy to make sure that the ASC does have adequate resources to fulfil its role under this bill.

As far as investors and their ability to enforce their rights and sue a manager are concerned, the reality is in a two-tiered system that when something goes wrong very often the trustee is implicated and very often they are unable to act for the investor because they are being sued, too. Usually it ends up back in the hands of the regulator to look after it. So I think we have to look at the practicalities of how these things work.

People say that our bill is not as good as overseas. I hope you ask Alan Cameron a lot about that because he probably knows more than anyone. I think it is all too easy to selectively lift regimes and bits of regimes from overseas and hold them up as best practice. My experience in the 3½ years that I was at the ASC is that regulations have to work for a time, a place and a culture. We can learn things about overseas regimes. We can learn what worked for them and what did not work for them, but when you build regulation, it has to be specific to the industry, the stage of the industry's development, the range of style of investments that it covers and the cultural attitudes of the people who work in the system and who invest in the system. With this bill we have tried to build one that is going to work for us. Yes, it is different than overseas.

As far as competition is concerned, we welcome competition. That is what we are all about. If foreigners want to come in and compete in the marketplace, let them do so. If we are genuinely losing business to them because of our structures, we will do something about it so that we can effectively compete with them. But I think this bill gives us the flexibility to choose to do that.

In conclusion, the industry has lived under a cloud of uncertainty in this area for almost eight years. More importantly, the investors, who I am happy to see are represented here today, have been denied the improvements in accountability, protection and cost savings that this bill represents. No mechanism is perfect and people will always be able to criticise, but this bill has survived everything that has been thrown at it, including two independent inquiries and now your review. I guess our feeling is that everyone has talked enough. Now is the time not to look backwards but to look forwards, to build a strong, competitive industry and to get on with the job of looking after other people's money.

I request that our submission be incorporated into the record. I have also two other additional items to table. One is, hopefully, a very quick and simple way to understand the way the bill works, which we have used to explain it to people, and the other is a more detailed review of some of the legal aspects of the issues surrounding the bills, which I will now ask Stephen Mason to speak to. Thank you.

CHAIR—Thank you, Ms Ralph.

Mr Mason—The paper is being distributed to people now. Because of the time constraints the committee is under, I will not take you through word for word or even issue for issue; I will just pick some particular issues to which I think the committee's attention ought to be drawn. They are particular things that the committee members might feel concerned about.

The first one is the general question of improving investor protection and, basically, the relationship with the SIS regime and the other regimes that apply in relation to the financial

services sector, life insurance and so forth. I have gone back to my experience as a member of the collective investments review and taken the kinds of risks that investors might seek to be protected from—market risk, the investments will fall over; institution risks, the offeror will fall over; or compliance risk, the risk that the offeror will not keep its promises.

In each of those paragraphs that follow, I have drawn out the proposition that in the superannuation area, for example, there are somewhat different policy objectives that might lead to different ways of approaching those risks in each of the areas. I think when committee members come to consider SIS regime, life regime and RSA regime and compare it with the MIB regime, they will realise that a proper analysis really has to be driven by the policy environment that the regime is designed to address. It is not the same across the financial services industry.

The second point I would like to briefly make is to say again what the short effect of MIB is. It is to remove a mandated requirement that there be a separate trustee or investors' representative. It is not to abolish the notion of trustee or investors' representative. It is to place clearly on the operator of the funds direct fiduciary obligations to members just as a trustee. In fact, the bill makes the operator of the funds, the single responsible entity, a trustee of the scheme property.

In that sense, it is really bringing it back, if you like, to the whole notion of trusts, where the control of the investment process was located with the trust responsibilities. That is how trusts grew up. You had a person with trust responsibilities who made investment decisions. The present law actually turns that on its head. The manager has to go and find someone to be the trustee, but it is really the managers' scheme.

We had a very simple approach in the collective investments review: if there is a problem in identifying who is responsible for what because of that split, make the manager a trustee. It took sometime for managers to become accustomed to that, but that is the result of the bill—the managers are now trustees of the scheme property and they owe those obligations directly. I should have said the single responsible entity because there is nothing to prevent someone who is presently carrying out a trustee role using the transitional provisions to become a single responsible entity, but that is the effect of the bill.

I will not take you through the next couple of pages, which deal with capitalisation and whether you should have a fixed prescribed level of capital or some other method of capitalisation, but I will go to the question that has been raised in a number of places—whether the scheme members can enforce themselves the duties that directors and officers will have under the bill. We are not talking about the scheme members going against the responsible entity; we are talking about scheme members going against the officers and the directors, the controlling hands, of the responsible entity.

Obviously, we are only concerned about this where what the directors and officers have done has caused the responsible entity to breach its obligations and where that has caused a loss. If it has not caused a loss then there are mechanisms, including disciplinary mechanisms, for that to be taken account of. If it does cause a loss, I set out there at least two of the kinds of proceedings that scheme members themselves can take to recover that loss,

section 13(24) proceedings against the directors and officers as being constructively or knowingly involved in a breach of trust and liable as if they were the trustee accordingly.

The next point I want to direct the committee's attention to is the nature of the compliance committee, which is not a beast which was recommended in the collective investment review's report. When one is considering the provisions about the compliance committee, one needs to consider what its actual role is. The compliance committee, as we understand the bill, is not an independent trustee-like body that has separate responsibilities direct to scheme members. That would be inconsistent with the SRE principle. Its role is to help the SRE discharge its responsibilities in relation to compliance. It is not there to act for, or to protect, or to represent, scheme members; it is there to help the scheme responsible entity do its job. So, when one is assessing the bill, as it relates to the compliance committee, one ought to bear that fundamental point in mind.

The final point that I want to draw attention too is the question of preserving the option, which has been mentioned and has been discussed here, and members of the committee have taken an interest in that question. There is not a prescribed form of relationship between two parties under the bill. The trustee can be a single responsible entity. The single responsible entity could enter into any kind of commercial relationship it likes to help it to discharge its compliance or other responsibilities. It can outsource that function under the bill quite happily. What the bill says, so far as the investor is concerned, is that it does not matter whether that task has been outsourced, the responsibility still rests with the single responsible entity. That is where the investors can go. Given the time, that is where I will leave my remarks.

CHAIR—Thank you, it was a precise presentation, Mr Mason.

Mr Hawkey—Thank you. I originally had not planned to make any opening remarks, and this is a new experience for me, but sitting through this morning I feel inspired to make some off the cuff. So, if you would bear with me. From a manager's point of view, just really to make it clear, no manager actually ever sought this legislation. It is not without cost for us to implement and it is not without difficulty for us to implement. So, why do we enthusiastically support the legislation?

Basically, it is because it moves us forward into a new era and away from one of the past. The past was relevant to that time but it is not to today. Given the convergence of the industry, we see, both in terms of legislation, government policy and regulatory policy, a recognition of the convergence. We need a situation to work under where we are not arbitraging regulatory and legislative regimes, whether they be banking, insurance or fund management—all operating hopefully as a single responsible entity, but removing that arbitrage possibility.

We also have a completely new era of technology. Trustees had a very effective role in an era of manual records, for instance, where the fact that we maintained duplicate records of investments, income—you name it—and the frequent reconciliation of those two had a place. In an era of technology, with the absence of things like share certificates and having to actually man locked drawers and secure them, the whole operations of fund managers have moved forward. What this legislation offers us is the flexibility of a basically non-

prescriptive regime, but it also gives very effectively to the regulator the ability to develop and evolve policy in a very flexible way as circumstances change and problems are recognised within the industry.

The second point that I would make is probably basically in the area of compliance where I have some focus. I would hope that certainly the middle or larger fund managers that operate here in Australia, whether or not we have international parents, fulfil what would be seen to be international best practice and compliance. Many of us already have independent directors on our boards. Many of us have board compliance committees that are chaired by independent directors. What this legislation actually does for us is to move what is international best practice across the whole of the industry, so that whether you are small, or whether you are medium sized or large, international best practice on the compliance front will apply. Certainly for those who are smaller, the flexibility is offered for that to be outsourced at reasonable cost, and probably very efficiently provided by ex-trustees.

If, again, I relate it to our past experience in compliance and the role of the trustee in that area, in 30 years of being involved with unit trust, or managed funds as we are now calling them, I have never once had the experience of a trustee coming to visit me, as a manager—and I have worked for a range of organisations; I have never once had a trustee come to visit me to review the controls and procedures or integral functions like valuations of trusts. The reliance that has been placed by trustees has basically been on the role of the external auditor. The role of the external auditor in this legislation is laid down and established as part of the integral checking and control procedures that we would operate under.

The reality is that we have the ability under this legislation to move forward to a new era, as I have said, to use the best elements of compliance regimes in a competitive environment, and to be able to very flexibly adapt those from an industry point of view, from a regulatory point of view, as we need to do it in a very dramatically changing environment.

Ms Howard—Similarly to Mr Hawkey, my role here today was not to speak to the committee but to assist the committee in any questions that they may have. Just a couple of observations may pre-empt questions. We work within Mercury with independent directors on our board and they head our compliance and audit committees. The level of scrutiny that myself and my colleagues at times endure on a quarterly basis is something that, if it occurs throughout the industry, is to be applauded. The questions that we are asked, the hoops that we are put through, certainly would assure any investor.

The other issue is real time scrutiny of investments. The real time scrutiny that occurs within most investment houses is systems that they have built themselves over the last four or five years, which are electronic, which, by the next morning's trading, provide downloading of what has occurred the day before. That is where the scrutiny occurs. It is ourselves scrutinising our own businesses, ensuring that we have managed our money according to prospectus and investment mandate requirements. The other issue is about costs. What I perceive as the additional costs for us will be audit requirements to have our compliance system audited, apart from ongoing transitional costs over the next 12 months.

Senator CONROY—I have just two quick questions. I have to go to chamber duty at one o'clock. In your booklet here you describe that many countries require single responsible entities. How many of them mandate custodians? Is it common that they are mandated? Are one or two mandated or are the majority?

Mr Hawkey—I would think the majority of regimes do have mandated arrangements, yes.

Senator CONROY—We had some examples that I think you were all here for, that talked about the 30 per cent over-valuation of a property, and there was clearly a related party. I am sure that would go on undetected now. Can you give us an assurance that it would go on less under the new regime?

Mr Hawkey—I know there has been a comment that you are reviewing this legislation without knowing the ASC policy, but, from an industry point of view, we would expect that the regulator would apply very different conditions in different areas. If you are offering products, if you like, where valuations would perhaps be more flexible, then I would expect the regulator to have a very focused approach to their conditions and requirements in that area.

Senator CONROY—Should there be mandatory requirements to avoid things like related party transactions, overcharging of fees—not that I am sure how you could mandate something like that—real valuations and that sort of thing? Would you see that just being a code of practice or a code of conduct?

Ms Howard—Belated party transactions will be picked up under the Corporations Law so that the normal related party transactions that apply will apply. Then I think it has to be the controls and procedures that are put in place in your compliance plan. Obviously the committee has not seen what is in the ASC policy statement about compliance plans, but property trusts are a different animal to an equity trust to a tax driven scheme like a vineyard.

Mr Hawkey—The bill has arrangements that ensure that the scheme property is valued at regular intervals appropriate to the property or the kind of property. In relation to the compliance plan, the responsible entity is under an obligation as one of its principal duties to ensure—not strive to ensure but to ensure—that that compliance plan is followed and implemented. That, in fact, is backed up by the harshest of the sanctions in the Corporations Law, the civil penalties regime.

Senator CONROY—Most of those things would apply now, wouldn't they?

Mr Hawkey—No. They are covenants under the approved deeds. The level of sanction, if you like, has been upped. The standard to be complied with by the responsible entity has also been, to some extent, upped.

Senator CONROY—Upped in a mandated sense or just in a regulation shift by the ASC?

Mr Hawkey—The law does not tell you what is an appropriate interval. As Ms Howard has just said, there are a vast range of kinds of property out there. The regulator, when it licences the scheme, will check that the valuation arrangements are at least obviously appropriate.

Mr Mason—The constitution law or replacement of the trustee, if you like, also drives directly to frequency of valuation and method of valuation. They are requirements in relation to disclosure and in promoting such a trust.

Mr Hawkey—I would have thought the valuation arrangements are in fact a key issue in disclosure. On disclosure, you did have some warning that one or other of us might actually do this. We would highlight that the experience with disclosure has placed that responsibility entirely upon the manager. The trustee has never accepted any responsibility on the disclosure front. In fact, prospectuses will carry the disclaimers that have been referred to which state that 'the trustee has not had any involvement in the preparation of any part of the prospectus other than any particular reference to them and that the trustee expressly disclaims and takes no responsibility for any part of the prospectus and makes no statement in the prospectus and has not authorised the issue of it.'

Senator CONROY—What I am probably looking for at the moment is an enhanced position rather than a neutral or, as is suggested, a lesser position.

Mr Hawkey—What I would highlight in relation to any related party transaction is that complete liability for disclosing and highlighting the actual fees and transactions that have occurred between related parties rests on the manager. It always has, particularly in an era of concise prospectuses where they are more readable and understandable. Issues like this are meant to stand out and jump out to investors so they understand what they are paying and what the arrangements are they are entering into.

Ms Howard—We have a property trust. It is a wholesale vehicle only for our wholesale clients and our portfolios, but we have already determined what sort of regime we have to have in place for that vehicle as opposed to other products. The internal controls and procedures for that trust are quite extensive and quite thorough. It goes all the way up the chain to the compliance committee and, as presently structured in our organisation at the present time, to the board before a sale would be approved. There would be a check and balance that would say that there is something wrong here. What is the property fund manager doing? Getting this from one of his golfing mates? It just cannot occur.

Senator CONROY—It cannot occur in your example in the way you have your structure.

Ms Howard—A plan has to be approved and signed off by the directors and lodged with the ASC.

Senator CONROY—Under your compliance regime or under the mandated scheme?

Ms Howard—No, what we propose under the Managed Investments Bill. We have already worked out—assuming that the bill is passed, because we have to do some plan-

ning—what we would institute for the property trust vis-a-vis our equity based products. So it is quite a rigorous procedure to ensure that, when we are acquiring a property, we are not acquiring it from a golfing mate of the property fund manager, that all valuations are obtained from proper evaluation companies and all of that sort of thing.

Senator CONROY—Is it now mandated under this new bill that it would be compulsory to get an independent valuation?

Ms Howard—Yes. As Ms Ralph alluded to before, for every example that one can cite of something like that, one can cite similar examples.

Senator CONROY—That is why I am looking to lift the level rather than just leave it the same.

Ms Howard—I think the system does lift the level because it is quite immediate. It is a system that relies on the integrity of people. We are all human. We would like to think that we recruit the best people, et cetera, but you rely on the robustness of your procedures and the quality of the audit process as well.

Mr Mason—Perhaps I could just finalise that by saying that the bill does not prescribe what a compliance plan should be for each particular organisation. The bill says that you must have a compliance plan and that it must be appropriate to your operation and circumstances. It recognises that different mechanisms will be required for different kinds of schemes, different kinds of property, different kinds of institutions and different ways that institutions arrange themselves internally. What the bill does is require the responsible entity to work out how best to secure compliance within its organisation for its scheme to make that public and to have that as part of the approvals process with the ASC.

Senator CONROY—That has to be registered with the ASC.

Mr Mason—It is lodged with the ASC. It is there. It obviously has to be disclosed. It is an important matter for investors to consider when they decide whether to come in or not. That is the approach the bill takes rather than saying, 'There shall be a mandated, prescribed given from on high.'

Mrs JOHNSTON—We have heard a lot this morning about best international practice. Could one of you give a view as to how you see this bill ensuring that that is what we will have in Australia.

Ms Ralph—Personally, I think this whole issue of best practice is a rather vexed question. It is quite easy to talk about, but I am not sure what it actually means.

Mrs JOHNSTON—Thank you. That is an honest opinion.

Ms Ralph—Is best regulation most regulation? Sometimes I think that is the trap we fall into because we do not actually know the answer to this question. What is best is what we think after we have spent eight years thinking about what is best for our climate, in our environment, in our industry, with our culture and how it works. I find it very difficult to

know what it is best worldwide other than to say, 'But they've got more.' I think that, having sat through the Wallis inquiry, the whole point of that was to say, 'Look, more is not necessarily better. Let's get the right regulation for ourselves.' I do not know if anyone has a different opinion on it or something to add.

Mr Hawkey—Some elements of what I would refer to as best practice certainly include the role of independent directors—who you have heard this morning place their assets and their reputations on the line, that separates them from the day-to-day running of the organisation and provides them with an overview. I certainly believe that the institution of board compliance committees—well ahead of the legislation requiring it—brings people very focused on the controls and procedures in the company. The same non-executive, independent directors look from their perspective at how we protect the interest of investors and how we at the same time minimise the risk and exposure of the company, both reputational and financial.

In this industry, our brand, our name as an organisation, is the most precious thing that we have and that is the same issue that independent directors contribute to these structures. No-one chooses to put those at risk, and certainly non-executive, independent directors are there for a fee. They are not there for a profit share or a component of the revenue that the company produces. Their liability is well and truly declared.

Another component clearly is the full documentation and monitoring of procedures and controls so that anyone—whether they be a regulator, an investor or a research house that wants to have confidence in our products that they are recommending—can come, and do, and look at the controls and procedures that are in place. That is, how frequently they are monitored, how quickly errors that inevitably occur are picked up, how they are dealt with and how funds are returned to the trust in the shortest possible time if there is ever anything like a pricing error.

Mr Mason—My approach to that question is it must be an essential element of best practice that the regulatory structure forces offerers to internalise compliance controls—that is, to make it part of their own systems and cultures within the institution. You could say an argument could be made that the present law externalises that by putting it in the trustee. You might hear that, if we can get it past the trustee, it is alright, whereas a best practice system has the operator having all the sorts of things that are required to be dealt with in the compliance plan internalised into its own operations. In that sense, you could say that the bill mandates best practice.

Ms Ralph—I must admit I think of this bill similarly to the changes that we made many years ago in prospectuses where we sheeted the liability and responsibility back to the directors—the people who really knew the business, the ones who could control the business and control what went into the prospectus. When we put that responsibility and that liability back in their hands, it really focused their attention and they have lifted their game. This bill does the same sort of thing, and I think I am expressing what Stephen was saying in a slightly different way. It sheets all of it back to one group of people who clearly know what they are responsible for. As Daryl has pointed out, already many people in the industry have the sorts of procedures and controls—like the organisations that are represented here today—

but I think this bill, when it sheets home that liability to the single responsible entity, will lift everyone. I guess if that is what best practice is, that is what we are all trying to achieve.

Mr KELVIN THOMSON—In relation to the trustees, even if trustees do very little for the fees that they are paid, even if they do not make any difference to whether the ship goes down or not and even if, as the case of Estate Mortgage suggests, they will fight tooth and nail to prevent any compensation being paid to those who do their money in that circumstance, at the end of the day they are still there and they are somewhere for disappointed investors to turn. Even put at its least charitable, there is a case for that extra body to be there for disappointed investors. What is your response to that proposition?

Ms Ralph—They may be there, but how much are they there? If you actually look at the amount of money that they are currently responsible for and the fact that that will only grow in size and the size of the shareholder reserves plus some reasonable sorts of insurance coverage, my belief is that they are not really there at the end of the day and they are not there in sufficient quantity to really deliver on that promise.

Mr Hawkey—Clearly, the capitalisation of trustee companies varies as much as it does between fund managers. You have got fund managers with extensive capital resources and you have certainly got some with smaller amounts. Equally, when it comes to insurance, we carry exactly the same insurance levels of cover. I do not believe the industry's pocket is any less deep than the trustees. In fact, I would argue that it is considerably deeper.

Mr KELVIN THOMSON—The other issue I am concerned about is that, when we ask questions on this issue, a lot of the roads come back to the ASC—whether their resources will be adequate and on issues to do with how they will administer this legislation. You would be aware of the seven policy papers which they are proposing to release and which have not been released. This strikes me as making it difficult for us to look the electorate in the eye and say, 'We can assure you that levels of investor protection will not be diminished,' when we do not presently know how the ASC is going to deal with a whole swag of issues, like capital adequacy, measurements of the independence of directors or ongoing monitoring and compliance—a whole series of issues that seem to me to be very important. I know it is very difficult for us to look you in the eye after eight years and say, 'We still want to look at this thing'; nevertheless, I am concerned about that and wonder what your response is. Let me say that I do not think it is your fault. I think this is the situation the government has now put us in.

Mr Hawkey—I imagine you will have quite a number of questions for Alan Cameron on that area. I suppose we would recognise that it is very difficult for a regulator to release policy at any rate—certainly aware of the time spent developing it—without legislation being passed. I do not know that this is different from any other position where you have legislation before a house and the reality is that policy has to be finalised and completed after that period. We would love to have access to what that policy will be and what will be required of us. Certainly, we would read everything, from the Treasurer's speech to the work that the regulator is currently doing. That indicates that not just extensive effort and resources will be worked through, but real policy will cover these areas.

Mr KELVIN THOMSON—It is unsatisfying from my point of view when we have got a whole lot of submissions and a whole lot of people in our ear, as it were, saying, 'Investor protection will be reduced by this.' A significant part of the response to that concern is, 'No, it won't. The ASC will look after it.' Then we are in the situation where a lot of questions in that area are presently unanswered.

Ms Howard—My recollection is that this is not too dissimilar to 1994 when the Superannuation Industry Supervision Act was brought into place without regulations and without the ISC's follow-up guidelines. That is probably symptomatic of the passage of legislation through parliament and the pressures that come to bear in this situation. The regulations came out shortly after, whereas in this case—and Mr Cameron will be addressing the committee later—the understanding in the industry is that the ASC is fairly close to releasing draft policy statements.

Mr KELVIN THOMSON—Have you seen the submission from the Trustee Corporations Association? It talks about some 25 amendments. My query is: have you seen this and, if so, do you have a view on those amendments? It is difficult for us to canvass the whole 25 in a context such as this but, from our point of view as a committee, we are obliged to look at them and consider them.

Mr Mason—Yes, we have seen that. I think the paper that was distributed today, without going into technicalities, would address some of the concerns that gave rise to some of those amendments.

Mr KELVIN THOMSON—I am sorry, I have not read it. Does it express a view about the amendments, one by one?

Mr Mason—It takes it on an issue by issue basis, rather than seriatim, taking you through each of the recommendations in the paper. It would too long to read otherwise.

Mr KELVIN THOMSON—I understand that where they are proposing the mandated independent custodian, clearly, you are not supporting that. But then there are other areas—about directors' responsibilities, how compliance committees and so on should operate, whether there should be quarterly rather than annual reports, and areas like that—where I thought you might not be opposed to what has been put forward.

Mr Mason—I think it is fair to say that there are some suggestions, yes.

Mr Hawkey—There are also a lot of those that we understand the ASC to be addressing in policy. I suppose this legislation does not set out to be prescriptive in a legislative sense, but sets out to give to the regulator the flexibility to continually finetune those areas. We would not argue that there does not need to be policy and regulation in relation to those issues, but rather that they be dealt with in the most flexible way.

Mr Mason—I think you will see, Mr Thomson, if you go through the paper, that there are points of view expressed on the substantive matters that are raised.

Senator MURRAY—I think I can help you with the best practice discussion. In the context of this bill, best practice is probably the system where the least number lose money, the most number make money and society as a whole benefits. That, really, leads me to the question which is going to loom very large in the minds of the Senate when it considers this bill: will this bill and this new system result in less people losing money?

Mr Hawkey—I think we would be arguing that it offers, certainly, the structure by which less people should lose money and, should there be a loss, it offers a cleaner, direct way of resolving that. It shoots the liability for that loss home, so that you no longer have the range of actions that you need to take to establish blame, if you like. The very shooting home of that liability strengthens the whole process in terms of controls, procedures and recognition of risks. That should mean not just a more efficient industry but also a more ethical and focused industry that deals with risks.

Senator MURRAY—Is your answer yes? Will less people lose money?

Ms Ralph—If you have a perfect crystal ball, you should come and join the funds management industry.

Senator MURRAY—Let me explore this, because that is what is going to go through our minds. Bear in mind we are talking billions of dollars and millions of Australians. When parliament introduced road safety devices, we could actually track the decline in road deaths, ergo, the legislation and the procedures worked. The whole judgment of for and against the bill comes back to the question of whether investors will be more or less protected under the system. How efficiently it operates, the costs and so on, that is all important, but the real question that we will address is: will investors retain at least the same level of protection and, preferably, gain more protection under the new system? What you are telling us, very clearly, is that you will have more control, more responsibility and more ability to exercise the kind of judgment and managerial techniques which will look after investors. If you are right, that means, to my mind, that less people should lose money. You need to assure me that you are right, because I am going to have to go into that Senate and vote. If I make a wrong decision, I have to wear the consequences.

Mr Hawkey—As you have phrased that question, 'Is this better protection for investors?' The answer is, yes.

Senator MURRAY—Which means fewer people will lose money?

Mr Hawkey—Fewer schemes, fewer trusts, fewer managers, if you like, should get into a situation that involves loss. We would always have expected that loss would occur in the less resourced, less rigorous organisations—perhaps the smaller ones. As to how you actually quantify those—a particular situation can be a quantifiable large loss or a quantifiable small loss, depending upon the number of investors and the amount involved.

Senator MURRAY—Could I then move on. I think I would describe it as the Sweeney approach, if you like. Mr Sweeney's approach recommends that we trial the two systems in tandem. At the heart of that is that the investors would be offered an informed choice of going either for a regulated trustee style regime, such as at present, or for the new style. It is

possible, of course, for the legislation to be presented in a manner which offers the choice. How would you react to that proposition? Are you aware of Mr Sweeney's paper?

Mr Mason—Could I just beg your indulgence for a moment to backtrack? When we talk about loss, we need to tease out the reason for the loss. The bill does nothing about bad investment choices. You just pick a dud. The offerors under this regime, as they do now, sell their investment expertise. That is called market risk: the risk that the offeror will pick a bad investment. The bill does nothing about that.

Senator MURRAY—Mr Mason, if I can qualify it, and you are quite right to tease it out, I am really referring to the issues of fraud and deliberate manipulation of the system to—

Mr Mason—I just wanted to make that clear.

Senator MURRAY—And you are right to make that distinction.

Mr Mason—It is pretty difficult to quantify the level of that anyway. As to the alternative option regimes, it is possible to do that at the moment under the bill. There is nothing to prevent a structure very similar to the present approved deeds structure being marketed by offerors who think that that is to their commercial advantage. If their market judgment is that the investing public wants to see a trust deed doing the kinds of things that trustees presently do, they can enter into the commercial arrangements with trustees to do that.

Senator MURRAY—Mr Mason, I am sorry to interrupt you again. I think the bill says it is an option. The Sweeney route would suggest that you are obliged to make a choice. In other words, the investor would be obliged to make a choice.

Mr Mason—I am not entirely sure how that would work. Does this mean that an offeror has to offer both kinds of schemes? Are we looking at choice of fund here, too?

Senator MURRAY—There are other regulatory regimes where that in fact happens. Probably the super approach currently requires you to offer different systems and different choices.

Mr Mason—It does not require you to offer different kinds of regulatory structures; it will require you to offer different investments. The kind of regulatory structure is the same across those investments.

Senator MURRAY—But you are not instinctively averse to choice, are you?

Mr Mason—No. My own view is that the bill delivers that by letting the operators, who are actually closer to the investing public than the regulators, decide what is the mechanism and the structure that is going to appeal to the investing public.

Mr Hawkey—If I could perhaps comment; I would react with some degree of horror at the concept of a dual regime, if you like, of both legislative regulatory and, from the point of

view of the managers, offering, either as a single responsible entity or in partnership with the trustee.

Part of what this legislation sets out to do is to remove the confusion from the investors and give an understanding of who they see as being responsible and where the liability is. We would merely be multiplying that confusion many times over. I would suggest that the reality of what would probably happen is that the managers would say, 'Well, look, we're going to set up new trusts, new entities under the new legislation.' You would see the process of people moving across from one structure to another, but you would have an enormously added cost in the marketplace and great confusion and chaos, if you like.

CHAIR—If I might interrupt, Senator Murray, we have another witness, Mr John Johnston, who is unable to be with us this afternoon. If you do not mind, I would like to hear him now for about the next 10 to 15 minutes. If we could interrupt the questioning of the IFSA witnesses and let Mr Johnston appear, we could then resume with IFSA at 4 p.m. this afternoon.

Senator MURRAY—Mr Chairman, to be fair, I do not need to pursue this line of questioning any further. If you wish to dismiss the witnesses, I am at ease.

CHAIR—Is it onerous for you to come back this afternoon, because I have a couple of questions I would like to ask?

Ms Ralph—No.

CHAIR—Thank you very much.

[1.31 p.m.]

JOHNSTON, Mr John Robert, Private Capacity, PO Box 55, Campbelltown, South Australia 5074

CHAIR—I welcome Mr John Johnston.

Mr Johnston—I am appearing in a private capacity as an investor who has had some dealings with an investment that has gone bad. I must declare an interest: I am the acting secretary of the Australian Shareholder's Association, South Australia branch, but I have not colluded in the preparation of my submission. My submission is the result of discussing these matters with three or four people in South Australia—small investors—who are in similar situations, and that is how it has happened.

CHAIR—Do you wish to make a statement to enlarge on your written submission, Mr Johnston?

Mr Johnston—I would like to seek leave to have my submission and supplementary submission incorporated in the record.

CHAIR—There being no objection, it is so ordered. Your submission and supplementary submission will be incorporated in a separate volume.

Mr Johnston—I have listened to the previous speakers with very great interest. I was rather surprised that the Trustee Association of Australia did not mention the Australia-Wide debacle. I have covered that in my submission, and I do not intend to labour the point here. But I would like to say that the settlement that occurred in May last year was a win for the small investor, and I would like to pay tribute to National Mutual; they are the new trustee. I believe, and after having my memory jogged a short while ago I do recall, that National Mutual made sure that the settlement obtained was of that order. So I acknowledge National Mutual, and I also acknowledge the ASC for proceeding with an action under section 50 of the ASC Act.

I have addressed only a few points in my submissions. The responsible entity: I believe this Managed Investment Scheme Bill is going to make quite a difference to the small investor, but I have concerns about the responsible entity; I am sure the regulator will make sure they are put to rest. I would expect that entity to have very substantial assets of its own, adequate professional indemnity insurance—which others have spoken about this morning—a proven corporate governments record and strong evidence that it puts its clients' interests before its own. I have gone on to speak about the need for an independent custodian.

Most small investors would feel more comfortable if there were an independent custodian to take care of the property of the trust. I have drawn your attention in my submission to the Canadian model. I have also addressed the independent audit of compliance plans for larger schemes. I support the bill's provisions for the independent audit of the compliance plan. I note that there is provision for this to be done on an annual basis, but I suggest, where most schemes give their members a six-monthly report, that the responsible entity sends the full details of the audit with the half-yearly accounts, which we now receive. But I do not

support any submissions you may receive which canvass the use of the same auditors for the compliance plan as for the responsible entity itself. I think the use of two auditors is one of the safeguards in this proposed bill.

I come to my supplementary submission. This has evolved after speaking with my little group of other investors in Adelaide. I do not know whether it has been circulated to other people as witnesses at this inquiry. With your permission, may I just read some points from it?

CHAIR—Certainly.

Mr Johnston—While I do support the proposed role of the Australian Securities Commission, my experiences, as set out in the introduction to my original submission, and also the comments I have received from an investor friend of mine and verbally from three or four other investors, lead me to elaborate further. Responsible entity: I believe it is very important that the investors in a managed investment scheme do have a formal structure in place for a forum to be provided for them to meet and talk with the manager of a responsible entity on a regular basis. This could be achieved by having an annual general meeting of the scheme in a similar manner to that of a public company.

The purpose of the meeting would be: to receive the audited financial reports of the responsible entity and a separately audited report of the compliance plan; to question and receive information, explanations and answers from the responsible entity and the compliance committee as to the affairs of the scheme; to periodically consider the appointment or re-appointment of the responsible entity—suggest at least every three years; and, to appoint or re-appoint separate auditors to the responsible entity and compliance plan respectively. Conversely, the annual general meeting option would give the manager of a responsible entity the opportunity to demonstrate and acknowledge its direct accountability to the members of a scheme.

At present, investors in a scheme, be it managed investments or unit trusts, generally do not have a forum provided for them to meet with other members of the scheme or the manager—what is to become, under the Managed Investments Bill, the responsible entity—let alone any simple and convenient method of gaining formal access to the manager. The only formal access that is available is when sufficient members of a scheme take action in accordance with the trust deed for the managers who call a unit-holders' meeting. This takes a lot of organisation and personal cost on the part of committed and determined investors and generally occurs after the scheme has suffered losses due to either imprudent and/or unauthorised transactions. To the compliance committee: I would like to see at least two investors elected by all members of the scheme.

CHAIR—Thank you very much. In your original submission, you said:

I also note that the Bill will give the Australian Securities Commission powers to decide what custodial arrangements are appropriate where the Responsible Entity is the custodian. If the ASC has to make separate custodial arrangements, then the Responsible Entity involved should not be the Manager of the relevant Managed Investment Scheme in the first place.

Yet, prior to that, you have written about the need for an independent custodian. Couldn't you make the same argument generally that, if a scheme needs an independent custodian, that entity similarly should not be involved in managing that investment. For what specifics does the ASC require particular custodial arrangements, as against a general requirement for custodial arrangements?

Mr Johnston—Having listened to Mr Cameron in Adelaide last night speaking on investment risk, I would be quite happy to leave that in the hands of the regulator. But, in my mind I wonder: if the ASC has to appoint a separate custodian, is there something wrong with the responsible entity?

CHAIR—Are you in favour of a mandatory requirement for a custodian or not?

Mr Johnston—As I said, after listening to Mr Cameron last night, I do not want a mandatory requirement there. I am sure the ASC will be able to do a very good job.

CHAIR—With regard to Heine Management Ltd and the proceedings of the unit holders' meeting, you talked about the trustee voting units they were not entitled to vote. Could you perhaps expand on that or clarify what happened there?

Mr Johnston—I am speaking from memory now. There was a block of votes in a subsidiary trust of the Aust-Wide Flexi Property Fund and the trustee should not have voted those units. I cannot recall the whole thing. I have got a file about three inches thick. It is in Sydney with somebody at the moment, but if the committee wanted to know why, I would certainly get the information.

CHAIR—Was any action taken as a result of that occurring?

Mr Johnston—The ASC took action, but Heine Management took them to court on a technicality because the objection to this deal going through was not in the minutes of the unit holders' meeting. Apparently, there was some obscure little clause in the trust deed that, if there is no objection at the unit holders' meeting, the transaction could proceed on those votes. But I recall that the judge chided Heine Management on a technicality. But, as I said, there was this thing in the trust deed and Heine got away with it.

CHAIR—You are asserting that the trustee was negligent in some way in its responsibilities?

Mr Johnston—I am not saying that. I have not read the trust deed. All I can recall, from memory, of those court proceedings—I did attend several days of them—is that there was something in the trust deed that said that if nobody objected to the resolution at the meeting, that is, if it was not recorded in the minutes, the thing can go through.

CHAIR—And you are saying people did object, that the objection was not properly recorded?

Mr Johnston—There was a speaker who objected to it, but nobody made a move to have that objection recorded in the minutes. We only found out after the judge handed down his decision. It sounds strange, but that is what happened.

CHAIR—There being no further questions, I thank you for appearing before the committee and answering our questions.

Mr Johnston—It was a pleasure.

CHAIR—The committee stands adjourned until 4 p.m. this afternoon.

Proceedings suspended from 1.43 p.m. to 4.04 p.m.

CAMERON, Mr Alan John, Chairman, Australian Securities Commission, GPO Box 4866, Sydney, New South Wales 2001

SEGAL, Ms Jillian Shirley, Statutory Member, Australian Securities Commission, GPO Box 4866, Sydney, New South Wales 2001

TANZER, Mr Gregory Mark, Regional Commissioner (ACT), Australian Securities, GPO Box 9827, Canberra, Australian Capital Territory 2601

CHAIR—I declare the hearing on the Managed Investments Bill reconvened. It is our intention to hear the officers of the Australian Securities Commission, because of the travel arrangements they have made. Mr Cameron, do you or your associates wish to make an opening statement to the committee?

Mr Cameron—I will make a brief opening statement, and it will really cover just three things. It will cover our overall approach to the bill, it will say something about the mandatory custodian requirement proposal and I will say something about what is happening with the development of our policies.

First of all, if I could start with the concept of the single responsible entity. There seems to be a tendency to believe that the bill proposes replacing trustees with the Australian Securities Commission. I do from time to time hear references suggesting that people think that is what this bill is about. I need to make it clear that we do not see that as what this bill is about at all. But, even before you get to that point, it is worth reflecting on just how that works under the present law.

The present law refers to the requirement for an approved trustee and an approved trust deed to be brought into existence in order to offer a collective investment scheme. But the law does not prescribe anything about the trustee. That is not in the law; it is not in the regulations. So members of the Trustee Corporations Association or any other approved trustees under state laws become eligible to become trustees because the commission approves them. The commission has published a policy statement that sets out the requirements that it will impose on those who wish to be approved as trustees. Under that provision all of the state authorised trustee companies are able to be trustees of the collective investment schemes that are presently offered.

I mention that really only to show that the law, as it presently stands, does not need to and does not in fact prescribe all of the matters that you need to know in order to see how the scheme of regulation works. I think one of the basic criticisms that I hear of this bill is that it does not seem to have all of the detail in it that you might expect to find. I do not think that is at all surprising because the law is outcomes based. It sets out what the result is to be; it does not tell you how you get there. In some respects that is the way the present law works as well, as I have just, I hope, demonstrated. But this takes the outcomes based legislation to another step. So we think that what this bill provides is an integrated approach to regulation, and I have sought to tease out perhaps 14 elements of this integrated approach

in order to show that it is not just the ASC replacing the trustee. It is not the ASC replacing the trustee at all.

First of all, there is a requirement for a responsible entity to be licensed, and you know about that. You know that there has to be a registration of the scheme with the ASC. You know that there are direct fiduciary obligations imposed on the responsible entity and its officers and employees. Those obligations replicate and add to all of the existing obligations that apply to company officers and directors: the obligations to act honestly and exercise appropriate care and skill, to act in the best interests of members, to treat members equally and fairly, not to make improper use of scheme information, to ensure that scheme property is clearly identified and held separately from property of the responsible entity or any other scheme, to hold the property on trust, and to carry out the duties that are imposed under the scheme's constitution.

The fourth point is that there is to be a compliance plan. The compliance plan is to set out adequate measures to ensure compliance with the law and the scheme's constitution. Just stopping there for a moment, I have been hearing during the day distinctions between after the event and real-time regulation. My approach to the compliance plan is that it is very much real-time, continuous regulation. It is not about the government regulator, the Securities Commission, being the regulator. It is about self-control and self-disciplines that are imposed within the scheme itself, but it is also about those things happening on a real-time, continuous basis. It is not after the event regulation, and it is certainly not regulation at a primary level by the regulator—by the ASC.

The fifth requirement I suppose is the requirement to appoint an auditor of the compliance plan who has to report annually as to whether the responsible entity has complied with the compliance plan and whether it continues to meet the requirements of the law. The sixth is the requirement that the responsible entity must have either a board or a compliance committee with at least half of its members being external.

The seventh is that the obligation of the compliance committee and the auditor of the compliance plan is to report to the ASC suspected breaches of the law where they are not being appropriately remedied already. The eighth I suppose is that the scheme's constitution has to have something in it about how you deal with member complaints, and it has to provide something about withdrawal rights where they are appropriate, depending upon whether the scheme is liquid or illiquid.

The ninth is that the responsible entity as a licensee is subject to annual audit under the securities licensing provisions. The 10th I suppose is that the accounts of the scheme itself have to be annually audited and indeed half-yearly audited if it is a disclosing entity. Another is that the offer of interest in the scheme must normally be made by way of a prospectus, with all of the liabilities that attaches. The 12th perhaps is that, if the scheme is a disclosing entity, there is a requirement that the responsible entity be subject to the continuous disclosure provisions.

A 13th is a whole string of provisions that relate to the role of the ASC to monitor the schemes: the ability to conduct surveillance checks; to direct changes to the compliance plan; to accept enforceable undertakings; to remove the licence; to appoint, remove and appoint

temporary responsible entities; to wind up a scheme; to deregister a scheme; to enforce the civil penalty provisions; to seek injunctions; and to take civil action under section 50 of the ASC Act.

I am really articulating all of those things to say this is not just about a one-off replacement of a whole lot of trustees with one government based regulator. It is not that at all. It is about an entirely new approach to regulating the offering of managed investments. Therefore, the question that seems to be asked as to whether or not this reduces investor protection is not susceptible of an answer that simply relates to a question as to whether the law as such requires a custodian in every case.

If there were such a provision, incidentally, we would probably be, as we presently are, frequently granting exemptions from it or modifications to it. We already allow some schemes to operate with related party trustees where that comes into existence. You already know that in many other instances, such as trustee common funds, the trustees act as trustees of their common funds. I really mention that only to say that the mandatory custodian, even if it were there, would be only one part of a whole panoply of provisions that are being introduced.

Not only is there this whole collection of things that have to be done, that the law requires to be done; whether they ultimately bring about an improvement in investor protection or of the same level or a reduction will depend, first of all, upon a whole lot of measures that I am not quite sure how you would ever actually construct but, more importantly, upon what actually happens—what people do in response to all of these provisions. If we do succeed through all of this in creating a genuine culture of compliance among our Australian fund managers, that will be the best effective protection that Australian investors can get. But it is not about just one element of that proposal.

That leads me to the next issue, although I have mentioned already what I would tentatively call the 14th requirement in the panoply, which is the requirement for the scheme property to be held separately, clearly identified as property of the scheme on trust for investors. I must say it is a little hard to see why in most cases that will not mean some form of custodian. It is what happens under this regime that seems to me to be far more important than what is explicitly mandated as such—for the very reason that we would probably be granting exemptions from a specific mandate in a whole lot of cases.

As I have already mentioned, this bill takes an outcomes based approach to all of these requirements. It does not specify how you achieve things; it specifies what the result is to be. This is not unusual in current legislation. We see it as a general trend to head in that direction. We see, for example, that the United States SEC is heading in that direction in its most recent utterances on custody. In its most recent publication on foreign custody arrangements, it is allowing the custodians operating under US law to accept in the case of foreign assets an outcomes based approach as to whether the custody arrangements are appropriate in all of the circumstances and giving the same overall level of protection as would apply if the assets were held in the US under the standard US custody arrangements. That is outcomes based legislation, if you like, done by the regulator. That is exactly what we see this proposal as leading to if the parliament accepts it.

We intend, if this bill is passed, to issue minimum standards—not a prescriptive set of guidelines that must be followed in all circumstances—for the holding of scheme property. They will apply equally to responsible entities that intend to act as their own custodian and to those responsible entities that will engage some external party to act as their custodian.

In doing this we are having very close regard to the IOSCO principles; the principles for the supervision of managed investment schemes generally. We are certainly looking closely at the relevant regulations of the United States, the United Kingdom, Canada and Hong Kong. I have already mentioned these recent rules that have been issued by the SEC and we are having a good look at those that were issued in June last year by the Securities and Investments Board, as it then was, in the United Kingdom.

We are also mindful when we do this, though, that this is not a single homogenous industry. We have to worry about the full range of participants in this industry. At one end you see the large—sometimes very large—equity trusts, cash management trusts, property trusts, holding very large investments for a very large number of investors. But, and I venture to say unlike the United States, this industry in Australia also includes film schemes with a handful of investors, macadamias, ostriches, apples, all sorts of very small agricultural and frequently agricultural based schemes or very small property based schemes. The whole panoply of custody arrangements, and indeed the full trust deed—trustee manager routine that you might think applies across the board, may not be appropriate for them at all.

It might be very difficult to persuade the very large trustee companies—as I think we were discreetly reminded this morning—operating for the large part in capital cities, even to act as the trustees for a lot of those. We notice that a lot of agricultural schemes have as their trustee smaller groups, some of them based here in the national capital, which provide the same sort of services, but they are quite differently structured companies.

We have to ensure that whatever regime we come up with is appropriate to all. It will not be a single regime of course but will permit a range of remedies to be adopted, a range of procedures to be adopted, that will match the needs and be appropriate to all of those types of schemes. What will it cover? The custodial standards will have to deal with the structure of custodians, the staffing capabilities, their ability and resources to perform whatever the core administrative activities will be, arrangements on how the assets will he held, and their financial resources.

We did hear this morning quite explicitly some of the strict rules that apply in the United States with respect to the large equity trusts. I think they provide quite useful guidance and we are certainly taking all of that into account. There is nothing to stop us adopting all of those same rigorous rules. We would only do so after consultation with industry to make sure they were applicable. But we can adopt all of those by way of our policies that we will publish in the next few weeks for consultation.

Where a responsible entity intends to act as its own custodian, however, we will consider putting on additional monitoring requirements. We would have in mind, for example, whether the board, or perhaps its compliance committee, should meet at least quarterly to satisfy itself that these obligations with respect to holding the scheme property are being complied with. There might need to be a regular audit of the custody of the scheme property

as part of that arrangement. Where they intend to engage an external custodian, we would expect that the responsible entity would have to satisfy itself that the custodian met our custodial standards. But we might also require the board of the responsible entity or its compliance committee to satisfy themselves that they still do meet those standards, so that it is an ongoing and not a once-off proposal.

Perhaps I should make our attitude to compliance plans generally quite clear too. We have never understood that the compliance plan, as approved and lodged with the ASC, will be a detailed step-by-step precise description of absolutely everything that a responsible entity will do to assure compliance. We think that would be impossible and inappropriate. What we want to know instead is that an appropriate process has been followed in order to develop what compliance arrangements will be there, and that these arrangements will be described, but only in sufficient detail for anyone to be able to assure themselves that this is happening. It will not be down to how many people will staff the back office at any time, and precisely what form of audit will be undertaken, and when and by whom. We would not have in mind ever being as prescriptive as that.

The final thing I should say before taking your question is simply to confirm that we are well advanced in the preparation of these detailed policies. The commission faced a somewhat exquisite dilemma. It is obviously not appropriate, and we would not dare to presume upon parliament passing this legislation at any time or in any particular form—that is not our role. But, on the other hand, we and the industry have had to have regard to the fact that the government has made it clear that it would like this legislation passed and in place on 1 July. If that is to happen, the industry needs to know what the arrangements would be. We are well engaged in that consultative process and we certainly hope to be able to issue the papers, still as a draft and without assuming anything at all about what the parliament does with the legislation, and we may well have to go back and revisit them fundamentally, depending on what does happen. We are aware of that.

But we thought, and the industry thought, I think, that it was an appropriate thing to do in order to ensure that we were ready for 1 July, in the event that parliament does pass the bill in that time frame. I am sure there will be other things you wish to ask me about, but it might be appropriate to stop there and give you the chance to nominate those areas.

CHAIR—Thank you, Mr Cameron. What role has the commission played in protecting investors in managed funds over the past, say, 10 years? Have you been filling a breach that the trustees have not, or where the trustees have not acted in a timely fashion?

Mr Cameron—I suppose the two large trust collapses that have caused most attention in recent times have been the Estate Mortgage and the Aust-Wide matters. In the case of Estate Mortgage, the commission did not need to take civil action on behalf of investors because the newly appointed trustees were able to take that action on behalf of investors. As you know, those proceedings were settled last year. While we did not take civil action we did take what I would regard as effective criminal action. The officers of the manager who had mis-described the nature of the investments and so on were all charged and convicted and eventually gaoled for those offences. The commission took what I think you would regard as effective action in that matter.

In the case of Aust-Wide, the commission took the action itself, under section 50 of the ASC law, on the basis that the investments made by the trustee had been both unauthorised and imprudent. Those proceedings were eventually settled and the investors in the Aust-Wide Trust have received a significant part of their investment back. It is worth noting that, although the recovery finally amounted to some $100 million, that did not put the investors back in full possession of their funds. It was not possible for the commission to settle on any more favourable terms than that. We got as much as we could, but it did not restore the unit holders to 100c in the dollar. I think those are the two leading examples.

The commission does not believe that it should be the only enforcer of the rights of investors in these matters. I have been talking to Senator Campbell about whether, under the corporate law economic reform program that is under way at the moment, which proposes a statutory derivative action in the case of companies—I have suggested this and we will formally suggest it—that some consideration be given in the CLERP process to putting the statutory derivative action also in for managed investments, where I think it could perform a useful role as well. That would mean that investors would not be solely dependent on the ASC.

CHAIR—Correct me if I misunderstood what you have said, but I understood you to say that in the current law there is no requirement for the appointment of trustees?

Mr Cameron—No, if I have said that I am sorry, I have misled you. There is a requirement for a trustee and for it to be approved. My point is rather that how you identify the resources of the trustee, the capacity of it to perform that role, the financial resources and so on, that would mean that it should be approved, you will not find in the law or indeed in the regulations. For example, if you were a United States regulator trying to decide whether to admit an Australian unit trust product, as it would now be, to circulation in the United States, you would not look at the law to see what sort of company was likely to act as trustee. You would have to look at the practice—what actually happened under the regulations and the procedures that were followed.

Our regulators all over the world do this. Mr Tanzer spends a fair bit of his working life talking to the other regulators in this area, teasing out the principles—not just what is written on the page but what actually happens—in order to ensure that there is some comity in the way these products can be brought into existence.

I think he would say to you, though, that to get recognition of these products between jurisdictions is extraordinarily difficult and probably not possible on a multilateral basis, but rather bilateral. I think Dr Dwyer said to you this morning that the United States had let no foreign funds in. Our information is that they have let 19 funds in. They are all from Canada, under the special bilateral arrangements with Canada. But no-one else has been allowed into the United States, and it has nothing to do with any sort of suggestion that this law would change that. It is rather to do with the general United States protective attitude to US investors. I do not believe, and Mr Tanzer might wish to elaborate, that this will change that at all.

I have now had the opportunity of reading the letter from the US SEC to which Dr Dwyer referred. When I read that letter, I do not see anything in it that suggests that I am

misunderstanding their attitude. It makes it clear to me that they will still not be letting in Australian funds in the foreseeable future, whether we change these rules or not.

CHAIR—Earlier today in the hearings there was some discussion about world best practice in this field and the suggestion that, if you looked around the world, you would see that a single responsible entity was not the norm. There was also some discussion on how you determine what world best practice is in this area. Can you shed any light on that issue for us?

Mr Cameron—It is a nice question. I heard Lynn Ralph querying the concept of world's best practice, and I can understand that. There is a risk of some world's best practice in fact being the lowest common denominator. One of the things we do through our active participation in IOSCO is seek to ensure that you can tease out the real underlying principle, what outcome you are seeking to achieve. For example, if you look at the latest IOSCO document from September last year on this very subject, you will see that it uses language very reminiscent of the bill. It is really about holding assets separately and keeping them clearly identified and keeping them apart from the assets of other funds and so on.

How you achieve that is something that could be different, depending upon local circumstances and local law. Mr Tanzer might wish to comment, but I would not have thought there was anything in this bill that is incompatible with that. But it comes back to the fact that the bill does not prescribe all of the detail about how you achieve that outcome. The commission certainly expects that custodial arrangements will be a very large part of its role in ensuring that the implementation of this bill achieves a standard which would be regarded as consistent with the best practice followed around the world. Would you like to say any more?

Mr Tanzer—Yes. I might just add one or two comments to Mr Cameron's. The ASC is a member of the International Organisation of Securities Commissions, IOSCO, as you would be aware, Mr Chairman. That organisation comprises most of the securities regulatory authorities from around the world. It does work on exchanging information about the appropriate level of securities regulation and it also seeks to develop common understandings and common principles underlying that regulation.

Working party 5, which is the one that I chair, is the working party related to investment management and managed funds. The chairman, Mr Cameron, has referred to some work that was done in September 1997. It is actually quoted, I think, in one of the submissions that has been made to you from Arthur Robinson and Hedderwicks which quotes parts of that document. The document was entitled *Principles for the Supervision of Operators of Collective Investment Schemes*. It runs through 10 principles for supervising operators of what we would call managed investments. It states the outcome that is desired from regulation in this area. For example, one principle states:

Supervision of an operator should seek to ensure that any transactions undertaken on behalf of a collective investment scheme with a connected party, the operator does not conflict with the operator's obligations to act in the best interest of the collective investment scheme.

That is, if you like, directing the regulator's attention to making sure that related party transactions do not conflict with the interests of beneficiaries to the trust or holders of interests in the scheme. The particular principle that is relevant to the issue of custody is principle 4. It states:

> Supervision of an operator should seek to ensure that the assets of a collective investment scheme are properly held in safe keeping and segregated from the assets of management and other entities.

The paper goes on to describe various ways in which that is done. It mentions, for example, that in many jurisdictions a custodian may be appointed to hold the assets, or to be in a position to ensure their safekeeping. The point of that sort of document is, as Mr Cameron has mentioned, to set out the fundamental regulatory underpinnings. We were involved in the development of that document and we are comfortable that the underpinnings suggested are catered for in the new bill.

The other thing about IOSCO and the work that is done there is that, as Mr Cameron has said, we have heard a little today about international competitiveness and the possibility that this bill will put us into a position where overseas regulators may be less likely to see our system as being of an appropriate quality. IOSCO working party No. 5 undertook quite a detailed examination of the prospect of reaching a multilateral agreement on what should be contained in a managed fund prospectus, what should be required of a managed fund operator, and whether or not we could set criteria that people could agree on, so that if a person met that criteria they could be registered all around the world—or at least in the jurisdictions in which those members operated.

We agreed that it was simply not possible to do that on a multilateral basis. Fundamentally, the reason for that is that it takes a far greater degree of analysis and discussion—at the detailed level that Mr Cameron is talking about—to reach that level of comfort that would permit a national regulator to reach an agreement to admit people from other jurisdictions into their own jurisdiction. I am not just talking about the ASC here. I am talking about national regulators all around the world. The result was that we did some work on what that bilateral agreement might contain. That now exists and has formed the basis for some agreements that various regulators have concluded, including the ASC, within certain jurisdictions.

The point is to emphasise that the particular statutory regime, of itself, does not determine the issue of international competitiveness. As Mr Cameron has mentioned, a lot more than that goes into the discussion. In relation to the US situation, Mr Cameron mentioned that there were 19 foreign funds. That also comes from some IOSCO work—just to give you the source, it was an IOSCO paper published in 1995. The interesting thing is that, at that stage, the last foreign fund approval by the US had been given in 1975—so they had not approved another one for 20 years. I do not know whether that is still the case.

Mr Cameron—We now know it is the case because Dr Dwyer's letter makes the same comment, that the last one approved was in 1973 or 1975.

Senator COONEY—We are not going to get into the United States.

Mr Cameron—No, we are not going to get into the United States anyway.

Senator COONEY—We can proceed on the basis that we are not going to get into the United States. No matter what we do, we will never get into the United States.

Mr Cameron—Not in the foreseeable future and not without some overall reassessment. I would respectfully suggest, if that occurs, it will happen on the basis of the overall regulatory scheme and not whether the law mandates separate custodians or not. It will depend upon what, in fact, happens in Australia.

Senator COONEY—Just to get this clear: the law in Australia is absolutely irrelevant to whether or not we get into the United States.

Mr Cameron—No, I would not go that far. Clearly, there has to be a statutory framework. I am really saying that they will go beyond the law, as they go beyond the law at the moment.

Senator COONEY—If there has to be a statutory framework, does the quality of that statutory framework matter?

Mr Cameron—Yes.

Senator COONEY—I thought that was all Dr Dwyer was putting—that the quality of your statutory framework is of some relevance in whether or not you get into the United States. Do you agree with that or do you say that that is not right?

Mr Cameron—It is clearly right. It is just the level of detail that has to be in the statutory framework—that is the only issue to me.

Mr Tanzer—My answer to that would be that you are right, the quality of the framework is important; but what is essential—and my experience in this area would suggest that it will be done on a bilateral basis—and what regulators are really interested in, is the outcome rather than the form that is used.

CHAIR—Mr John Johnston, in his evidence prior to lunch, put forward the proposal of an annual general meeting of managed investment schemes for the investors in those schemes. I am wondering what your view on that is and whether that ought to be mandatory or something that would be considered by the ASC in its laying down of the rules for particular schemes?

Mr Cameron—As I am sure you would know, Mr Chairman, there are some schemes at the moment that do have meetings and that is required under their present constitutions. Future single responsible entities could provide for such meetings if they wished. In some cases it may be appropriate and they should. In other cases it may be inappropriate and they need not. We simply say that it may not be a matter that the law needs to deal with in the sense that, if the promoters of the scheme and those involved with it wish to include meetings and it is appropriate to do so, they may do that.

One of the temptations is to equate managed investments to companies. Managed investments at the end of the day are not companies because there is a separation between ownership and management that is far more pronounced in the case of managed investments. There may not be the same necessity for an annual meeting in the case of managed investments that there has traditionally been thought to be in the case of companies. If that were to be mandated, I fear we would again be confronted with a whole lot of applications for exemptions on various grounds.

Senator COONEY—Instead of wandering around with questions, perhaps I can put a proposition and then get your comments. As I understand what you say, we have got to look at outcomes. If you take away the trustee companies, you have got a whole range of remedies, including custodial standards and even criminal action in the end. It seems to me what you are looking for is outcomes for your mums and dads, your Darby and Joans—you are probably not old enough to get that reference, but that used to be a reference. At least with the present set up they go off either to the management or to the trustee and something can be done. The picture I got from what you were describing is that they can go and get injunctions and they can have a look at custodial standards. People in their 60s and 70s get a bit shy of all of that. You seem to be loading people up with more issues to worry about.

To get on my hobbyhorse about this criminal action, what good does criminal action do in this area in any event? I do not say this in any way to condemn all the great work that you have done there, but you get people end up in gaol. They have been through the process, their wife has probably left them, they are broken in spirit and the money is all gone, and you throw them into gaol at an elderly age. What good does that do? Often times that is after you have spent years doing it and spent lots of money doing it.

I wonder what all these remedies do? You have got a lot of remedies. It seems to me that, if you take away the trustee company, you are leaving lots of people with legal remedies and with the satisfaction of seeing somebody go to gaol who is not going to pay them the money. They will get no return for their small investment. A man of your wealth can go to court, Mr Cameron, but somebody of my wealth could not, you see.

Mr Cameron—You seem to know something about my wealth that I do not know, Senator Cooney. I do not see this legislation as fundamentally transferring the obligation to monitor investments and so on onto the individual investors. I see this whole collection of steps involving compliance plans, independent directors, whether on the board or on compliance committees, an audit of that compliance plan and so on as a whole collection of remedies which taken together and working effectively should look after the interests of investors at least as well as, if not better than, they are presently looked after. If all of that happens, it should not lead to a diminution in investor protection.

Senator COONEY—But the small investor is not in control of any of that. With the trustee company, they can go down and ask them. With this one, they have got to go off to their lawyers and off to you and make a whole series of complaints. It widens their options, but it also imposes heavier burdens on them in the sense of their responsibility to do these things. The reason you are going for these funds is that you want somebody else to worry about them.

Mr Cameron—There is a requirement in the law that the scheme constitution include a method for bringing forward complaints from individual investors and having them dealt with. If it is at the level of the individual investor complaining about the withdrawal of their funds or the price at which that is happening, that can be dealt with. If it is at the level of an investor genuinely wanting to take action on their own behalf or on behalf of everyone—all the other investors—if the statutory derivative action that I was suggesting earlier might perhaps be considered by the government under the proposed CLERP legislation does not come forward, in extreme cases and in the public interest, the ASC could take that action for people under section 50 of the ASC law as it now stands. There are ultimate remedies. If you regard the scheme constitution method for handling member complaints as a way of dealing with the very small ones and the section 50 action at the other end as the way of dealing with major concerns, that may be sufficient—it is up to you.

I should say something about your reference to criminal remedies. The criminal remedies arise because the legislation proposes for the civil penalty regime to apply to the breaches of the fundamental obligations on responsible entities, and that will only be criminal in the case of egregious behaviour. It will normally be civil penalty proceedings. Clearly, you are right in saying that there would be no great comfort for the individual investors if that were to happen. The purpose is clearly to discourage the egregious behaviour in the first place. I would have thought, especially having regard to the tenor of some of the submissions on the subject, that the concern, if anything, is that that might put a very high standard of behaviour to be required from those who operate responsible entities. I think most of us would feel that was not a bad thing.

Senator COONEY—This is my last question. Do you agree that, as things now stand, at least the trustee company is seen to be separate from the management and is somewhere that the small investor can go and, if they are doing their job—and we presume they will—they would take all these steps that, I think, are really left to the individual to initiate under your scheme? You are not going to go around as an ASC and supervise all these things. You have not got the time or the resources, nor perhaps should you in any event.

Mr Cameron—No. As I say, it is not in any real sense our scheme; it is the government's proposal. It is a proposal that we are responding to as the regulator. We are explaining to the committee how we would administer it. In the real world, if people had a complaint they would probably use this member complaint mechanism and it should get to the independent directors who would assess it—the independent members, either of the compliance committee or of the board. That structure should be the way in which most of these matters are dealt with.

Senator COONEY—But what would you do if you were a smaller investor out of Broadmeadows? Do you go across to Toorak and knock on the door and say, 'Mr independent director, I want you to look at my problems. I have invested $500 in this.'? I wonder how real all this is in terms of outcome?

Mr Cameron—I think if it is that sort of complaint, the method for handling member complaints ought to deal with it in the first instance. If it does not, eventually somebody will have to bring it to our attention.

Senator COONEY—But can you see that those sorts of functions are presently formed by the trustee company?

Mr Cameron—I imagine they are, but it is not the major focus of the concerns that I hear with regard to what trustees do. The issue one normally hears about is more to do with their role in ensuring that the managers behave appropriately, rather than people talking about their role with the individual investors.

Senator COONEY—You are putting out, very lucidly, may I say, a whole range of machinery which enables the small investor to get his or her say about what is going on. All I am saying is that, at least under the present scheme, the trustee company performs a lot of those sorts of things—a bit like a one-stop shop. If I can talk about medicine—not that it has got any great relevance—in the Melbourne Private Hospital, you get one bill and not a whole series of things.

It seems to me that, under the new scheme, there is a danger that we will have a whole series of remedies, whereas it might be better to have one, for all its deficiencies.

Mr Cameron—The intention of the bill, as I understand it, is to be preventative; to ensure as far as one can that these problems do not arise in the first place. It is a matter of judgment as to whether this, as a whole, produces that result. I am simply arguing that it should be taken as a whole, and not focus on particular one-off issues.

CHAIR—I know that the ASC officers are on a 5.30 p.m. plane, so they will probably want to get away from here within the next 10 minutes.

Mr Cameron—We would certainly like to.

CHAIR—I was hoping they might be able to comment on the Company Law Review Bill as well.

Mr Cameron—We are leaving general counsel behind to deal with that for you.

Senator MURRAY—This is typical of my committee life. Senator Cooney takes all my time, and then the chairman says, 'Listen, they've got to go.'

Senator COONEY—I am leaving after that; I am going!

Senator MURRAY—Mr Tanzer, I go to you first: we know that some countries refer to the United States as the 'great Satan', but in matters of trade and access to their markets, other countries refer to them as either the 'great hypocrite' or the 'great opportunist'. The fact is, under the existing law, we have no access to their markets through these fund mechanisms.

Mr Tanzer—Under their existing law we have no access.

Senator MURRAY—But under our existing law we have no access.

Mr Tanzer—We have no capacity under our law to gain access. That is a matter for them; a matter for the executive government.

Senator MURRAY—Yes, but the assumption in what was said by an earlier witness is that it would be made more difficult. I think that assumption has not been proven. Following on from that, the commentary is that under the new law it will be no easier. Indeed, the view of some earlier witnesses was that it would be harder.

Mr Tanzer—That was a suggestion.

Senator MURRAY—What I really want to ask you is: under existing law they have access to our markets, don't they?

Mr Tanzer—There is a lot of technical detail around that. Perhaps I could provide you with better information about exactly what access and in what circumstances they have access.

Senator MURRAY—Do any US funds have access now?

Mr Tanzer—Yes, they do.

Senator MURRAY—Under the new law they would have access?

Mr Tanzer—Subject to the existing basis upon which we provide exemptions for certain participation still being there under the new law, yes.

Mr Cameron—We grant relief that enables them to come. In fact, they do not come for another reason—called tax.

Senator MURRAY—Yes, I understand that. The point is, we do not have reciprocity now and we are unlikely to have it next time around. I put a question on notice to you—it is a difficult question and I appreciate it will have an element of subjectivity and, therefore, qualification: firstly, could you indicate to us which countries we are likely to have access to, or continue to have access to, under the new regime which we already have access to under bilateral or multilateral arrangements; secondly, could you indicate which countries we do not have access to; and, thirdly, could you indicate which countries will remain very difficult to access—which I presume would include the United States?

Mr Tanzer—I am happy to take that on notice.

Senator MURRAY—Mr Cameron, the next area refers to your own role. You and your officers in the ASC are highly regarded. You perform your task now to the best of your ability and you would do so in the new regime. I hear no real criticism of your role now or under the new regime. The real thing at issue here is whether trustees should be part of the scheme—in the full sense that they are presently or in an improved sense. What I did hear, though, during the day, was that effects on your budget and resources—over which you have little control—may affect your ability to perform your function to your fullest capability. I did hear earlier today that you had, indeed, withdrawn some regulatory procedures which

were formerly in practice, for budgetary reasons. My question to you is twofold: firstly, is that correct—that it was for budgetary reasons—and, secondly, have there been any detrimental consequences as a result?

Mr Cameron—The reference made this morning, as I recall, was to our withdrawal of what I will loosely call the random surveillance of trustees of the present collective investment schemes. It is true that that has stopped, as a lot of random surveillance has stopped. What we now do is surveillance based on intelligence and complaints and so on—in other words, structured surveillance, surveillance with a reason and rather less of the entirely random surveillance. In most cases, and I think it is fair to say in the case of trustees, that change has occurred.

You can characterise it, if you wish, as in response to budgetary pressure, but it is rather better characterised as in response to a belief that it simply was not cost effective anyway. We were not finding enough evidence of non-compliance—of action we needed to take—through a random process to justify the expenditure of that time. My recollection of when we were still doing it—Mr Tanzer might have these numbers too—is that something like 90 per cent of both fund managers and trustees were in full compliance when we simply went and visited them without any particular concern or reason when we arrived.

That makes it a very expensive process. When the government made some changes in our resources—it started really under the previous government of course—we found it necessary to ensure that what we were doing was more effective. The way of achieving that was to make our activities more responsive to concerns that we already had than merely random. Does that answer your question?

Senator MURRAY—Yes, it does and in a strange way accords with my four per cent rule.

Mr Cameron—Entirely. If I may say so in relation to your four per cent rule, and I had a deal of sympathy with it, I really wondered whether it was overstating the real risk of fraud among fund managers though. I would be very surprised and concerned if it was as high as four per cent.

Senator MURRAY—Yes. I want to talk to you about perception and reality. I think Senator Cooney put his finger on a very important aspect. Very few investors would have the time, ability, knowledge, et cetera, to understand the law and the possibilities. Trustees, particularly for older persons, have a particular ring of credibility and honesty. They have an attachment, if you like, a perception. By changing the law you do introduce a sense of newness, I would think, which would make many investors uncertain.

Do you think it would be helpful if the new law, going the way it wants to, reinforced the natural role of trustees where that was to be offered as a choice—in other words, dealt with their deficiencies as presently defined? As the earlier witnesses clearly said, trustees will continue under the new regime. They do not fall away. They merely do not have the same statutory backing.

Mr Cameron—That is a difficult question. First of all, the single responsible entities are themselves now trustees under this arrangement. There may be a separate custodian, and we think almost inevitably there always will be a separate custodian of some kind or other. You are right that the newness of all of this will cause, I imagine, some confusion in the early days, bearing in mind that there are so many instances at the moment where there are single responsible entities—ranging from banks, life insurance companies, retirement savings accounts and superannuation—in which people deal with single responsible entities. If the language that is now used is that of trustee and custodian or manager and custodian in the selling documents that are offered, the public may need some time to get used to it. But I think the public will get used to it and will understand what the overall structure is. It is a matter for others whether you could imagine these two structures running side by side.

The traditional response by the government, as I recall, was that they were concerned of real confusion in the investing community if there were the two schemes running side by side. So I think the argument is that it would be better in effect to educate people as to the new single responsible entity structure with the rest of the compliance arrangements that I was describing earlier than to try to have a double system—a manager-trustee system operating side by side with single responsible entity concepts. I am trying not to advocate a position because it simply seems to me that that is fundamentally, at the end of the day, a matter for the government and a matter for the parliament.

Senator MURRAY—I am going to have to hope that you are good at pretending because I am going to ask you the question and then you are going to pretend I am still here because I have to go to a media interview at 5 p.m.

CHAIR—Mr Cameron has to go too.

Senator MURRAY—It is not that difficult to oblige fund managers when offering a marketing plan or a proposal to also require them at the same time to indicate the alternative opportunities offered by trustee schemes or to oblige trustees when offering their proposals to indicate that the alternative is available through funds. Do you think it is appropriate to legislate that so that that choice is deliberately and statutorily available to the community?

Mr Cameron—I think it would be very difficult to contemplate that the two offers could be made in the same document. I think offering investors in the same document a choice of compliance arrangements would be inefficient from the point of view of the fund manager and I think confusing for the investor. When I was answering a question earlier about the two schemes existing side by side, it certainly was not my contemplation that they might exist side by side in the same offer document. I think that is in the realm of the too difficult for people.

I am reminded that, in answer to that earlier question, I might have said, inevitably, a custodian. I do need to make it clear that the commission, while it believes that custodians will be required very often, is not saying that custodians will inevitably be required. I say that because there are all sorts of circumstances in which people might come to us and persuade us that they do not need a custodian. We understand the imperative of the law—that the assets have to be kept separately, apart and clearly identified and so on—and it would not be appropriate for us to have a policy that mandated something that the parliament

did not mandate. I do need to make it clear I did not mean to say that there will inevitably be a custodian if it all goes through in its present form.

CHAIR—Thank you very much, Mr Cameron, Ms Segal and Mr Tanzer.

Mr Cameron—I must apologise for having to go at this point. I hope that does not inconvenience the committee. We are certainly available if you wish to talk to us.

CHAIR—Everyone has exhausted their questions. Thank you very much for your time and answers to questions.

[4.58 p.m.]

HAWKEY, Mr Daryl, Chairman, Regulatory and Consumer Affairs Board Committee, Investment and Financial Services Association, Level 24, 44 Market Street, Sydney, New South Wales

HOWARD, Ms Kerrie, Chairman, Regulatory and Consumer Affairs Forum, Investment and Financial Services Association, Level 24, 44 Market Street, Sydney, New South Wales

MASON, Mr Stephen, Legal Adviser, Investment and Financial Services Association, Level 24, 44 Market Street, Sydney, New South Wales

RALPH, Ms Lynn, Chief Executive Officer, Investment and Financial Services Association, Level 24, 44 Market Street, Sydney, New South Wales

CHAIR—I now recall the Investment and Financial Services Association to complete their examination.

Mr Mason—Could I just say something which I should have said earlier on. I apologise for not mentioning it earlier. I obviously come from a law firm. The views on policy matters that I am putting forward here are my own and are not to be ascribed to the hundreds of partners in my law firm who probably do not agree on anything, much less this. So I would just like that borne in mind.

CHAIR—You heard a lot of issues raised in evidence this morning from other witnesses in terms of why the legislation should be amended to require the dual stream of management and trustees. Apart from the evidence you have given in your submission, are there any particular issues there that have been raised that you need to comment on?

Mr Mason—I find it a little bit difficult to see how the detail of such a proposal would actually work. I am not sure whether the proposal is that the offeror can or has to offer two sub-investment streams—one with a trustee custodian and one without—or whether the proposal is merely that the offer documents should refer to the involvement or non-involvement of a trustee custodian, and whether that is all that is being put forward as the proposal. If it is the latter, I do not suppose there is much difficulty. It is a matter that would have to be drawn to attention in a complying prospectus. In any event, what the custody arrangements for the scheme property are under the 10.22 test is certainly something an investor expects to see. If there have to be two parallel structures for each offeror, within each offeror I can foresee practical difficulties and unnecessary costs.

The third alternative is that the offeror with a vehicle without a trustee custodian has to draw attention to the fact that other offerors may have trustee custodians and, presumably, vice versa. It is a bit difficult to know what the offeror would say beyond that without falling into trade practices and misleading and deceptive problems. So I find some difficulty with responding to what is a rather incomplete proposal. It is the sort of thing that you really need to see the detail to see whether it has any chance of working at all. I come back to the proposition that was put to you: it is for offerors to decide whether they want to have the

advantage of a trustee custodian. It is their commercial decision. If, as has been the case before, they perceive a commercial advantage in it, they will do it—they do not need to be told.

Senator COONEY—I was not here when you presented what was no doubt a brilliant submission. The impression that I get at the moment is that the person we ought to look at is the offeror. That is within a limited number of issues, is it not, because the offeree must have some rights in all this, surely?

Ms Howard—The investor must have some rights.

Senator COONEY—Well, I use the word 'offeree' for the person who is opposite to the offeror.

Mr Mason—Yes. The investor certainly has to have rights. I do not follow how a proposal to have some sort of two system arrangement would give the offeree, the investor, more or better rights.

Senator COONEY—So are you saying that is a matter, when you are preparing a prospectus, or whatever else you prepare—

Mr Mason—You think to yourself, 'The investor will want to know, and will expect to be told in the prospectus, what is going to happen to the property of the scheme. Therefore, I have to tell them.'

Senator COONEY—That is if the law allows both.

Mr Mason—That is whatever the law allows. If the law requires a custodian, then obviously the investor is going to be interested in which custodian you have picked, so you will have to tell that. If the law does not require a custodian, the investor will be interested in whether you have a custodian and, if so, who it is. This is one of the things that the collective investment review's report very clearly said. The custody of the assets will be very important, not least in terms that that will have to be disclosed to investors under the 10.22 test.

Senator COONEY—I have got this concept that I am asking you to help me with. The way you are putting the issue, it sounds as if there is a parity of power between the offeror and the offeree.

Mr Mason—There is a parity of power in the sense that, unlike superannuation, no-one forces you to invest in a managed fund. You do get forced to invest in a superannuation fund.

Senator COONEY—But if you listened to what was said before about looking at it in terms of outcomes, one of the problems we seem to get into is to say, 'Look, you don't have to do this,' but in fact people do it. You do not have to drive on the road, you can always walk, but the reality is you would never get there if you walked. If you have a regime—and this seems to be the trend now—where small investors are going to be able to come forward and put their money into all sorts of shares, you have got to look at the reality of the outcomes. You may have people who are going to invest who do not know anything about

the law, who are not terribly interested in going off to the law and probably cannot afford to go off to the law. So when you are talking about the whole thing, to say, ‘They are like an institutional investor and you do not really have to worry about them’, just does not seem to me to really look the situation in the face.

If you have a regime—this seems to be the trend now—where small investors are going to be able to come forward and put their money into all sorts of shares, you have to look at the reality of that and you have to look at the reality of the outcomes. You have people who are going to invest who do not know anything about the law and who are not terribly interested in going off to the law. They probably cannot afford to go off to the law. When you are talking about the whole thing, to say, ‘They are like an institutional investor and you do not really have to worry about them’, just does not seem to me to really look the situation in the face.

Mr Mason—That kind of difference in the class of investors is something that has not been talked about a great deal here today, and possibly it is worth exploring a bit. Mr Cameron did draw attention to the requirement as part of the scheme structure that there be an effective complaints mechanism. That is the sort of thing that is presently required in all superannuation schemes. If you talk to superannuation trustees from whatever sector of the superannuation industry they come from, that kind of informal inquiry and dispute resolution process is very effective.

Senator COONEY—I was going to ask you to put on one of your former hats, if you are allowed to do that. How effective is it? There is no need for me to go into a long description of what I am asking. What about the small person who wants to get his or her voice heard? The mechanisms are fairly expensive.

Ms Ralph—Alan Cameron talked a little about what action investors could take. It might be useful if the fund managers who are here actually talk to you for a minute about what happens when they get investor complaints and what happens when there is a problem right now.

Senator COONEY—I think that is a good thing. That is not quite the question I am asking. If they do want to enforce their position, vindicate whatever rights they have got and go to a legal remedy, they really are not in a position to do so. What you are saying is, ‘Don’t worry about that. Don’t worry about their ability to go to the law because we have got a terrific scheme for you that eliminates the necessity for going to the law.’ I think that is the effect of your comment on what Mr Mason was saying. That is how I have taken it. Is that what you mean?

Ms Ralph—No.

Mr Mason—The question of the inaccessibility of the courts is one that has bedevilled legal policy makers for years, as you well know. The Federal Court does not seem to be assisting us at the moment in that endeavour to make dispute resolution mechanisms more accessible to ordinary individuals or more accessible to people without the resources, the power or the stamina to take on a court case. That is the case whatever kind of financial services vehicle we are talking about. It is the case with banks, it is the case with life

companies and it is the case with building societies and superannuation and investment vehicles.

Senator COONEY—Perhaps we ought to have trustees appointed to supervise them.

Mr Hawkey—It is not the experience that the industry complaints come through the trustees. It would be a very rare situation in which a complaint would go to a trustee.

Senator COONEY—I do not think that is quite what I am putting. At the moment you have a trustee company which is separate from your management company and, if you accept what they say, provides a degree of supervision, although it may be affable, as somebody said this morning. It seems to me that, once you take them away, you get to the point where you have to talk about the regimes that the management company sets up and you can go to law and what have you, which is tremendous. I have no doubt that everybody is sincere about that. But, if you look at legal rights, almost human rights, where you can enforce things, it seems to me that, once you have removed a company that purports and is independent and apart, you bring the issue of rights—human rights and legal rights—to the fore, more than it presently is. I want to get your comments on that.

Ms Howard—I suppose that is in theory how the system probably operates at the present time. I doubt whether it does in practicality. We are very concerned about our investors. We have investors in a range of age groups, ranging in ages these days from young people to people in older age groups. We are very concerned, I think across the board in the industry, that, if people have a concern with us about our investment performance, the manner in which we have delivered information to them, the timeliness, anything to do with our operation, that is heard and dealt with properly and efficiently.

Stephen has just alluded to the fact that the great difficulty with our entire legal system is that there is no redress outside of the courts. The Superannuation Complaints Tribunal, in the superannuation arena, offered that redress. It is interesting to note that the majority of the complaints that are dealt with by that tribunal relate to the really difficult issues about death benefits and disability benefits, where there has been competing spouses, one or two wives, or competing children where a trustee has had to make a very difficult decision. They are the sorts of issues that have come to the tribunal itself. The others either have been dealt with internally within organisations by public offer trustees and non-public offer trustees or have been dealt with in mediation. In relation to the system as it exists, I do not see that, if I were an investor and wanted to complain, complaining to the trustee would actually take me much further.

Senator COONEY—There is the complaining to the trustee. But, as I understand the way the trustees put it now, they reduce the number of complaints that you would expect to be made, because they supervise the management company in such a way as to eliminate these occasions for complaint. As you say, that is a matter of fact. You say that you do not think that happens now.

Ms Howard—We supervise ourselves. In relation to what our company has done with complaints, we were obliged to have a regime under SIS. We do not differentiate between a superannuation complaint and a complaint in one of our non-superannuation products. It

takes the same time and the same reporting to the compliance committee occurs. If it has not been dealt with in a timely manner, woe betide management, because no-one wants to front up before the compliance committee and explain why they have failed to address a unit holder's complaint.

Senator COONEY—That is an internal organisation.

Ms Howard—Yes. So nothing gets to the trustee. Their complaints are listened to.

Senator COONEY—Another committee is considering another issue—just to get away from this and into the immigration department. They say, 'We don't really need people to go off to the courts or off to the tribunals, because we can look after it internally.' The experience over the years is that that might not be a statement that is completely true on every occasion. If you are setting up internal tribunals within the system itself, there is a danger that they may not have the quality that they ought to. There ought to be some way of having quality control over that.

Mr Mason—Although the current fashion in government is to refer to subjects of the realm as 'clients', the fact is that the people that the Immigration Department deals with are by no stretch of the imagination its clients. The people with whom funds managers deal are people from whom the funds managers want repeat business—and that is a very significant distinction.

Senator COONEY—Thank you.

Mr Hawkey—The reality is that there are no investor issues that I am aware of that do get dealt with by trustees. There were several comments that I made this morning relating to our brand and reputation requiring us to resolve complaints—concerns even—by investors. I believe that it is a considerable step forward in the regime that is proposed under this legislation that there be formalised complaints tribunals. Because you are giving people, at low cost and in a very accessible way, an ability to take their concern before an independent tribunal, we are not imposing on people the cost and the inaccessibility of our legal system for small investors.

Senator COONEY—Do you go so far as to say that trustee companies do not provide any sort of check at all, or that the check they do provide is not worth the cost? What is the position that you put?

Mr Hawkey—The reality would be that, if an investor got on a phone to a trustee, it could only be one of two situations: firstly, where the situation had been so badly handled by the manager that they were seeking redress through someone else—and I do not have that experience; or, secondly, if they had phoned the wrong phone number and they had got through to the trustee in error. What would inevitably happen—and it does happen occasionally—is that a letter, if it were in writing, would immediately come to us to be dealt with; the phone call would be immediately referred to us to deal with.

Senator COONEY—But what I am saying is: leaving aside the client's complaints, just as a mechanism of providing a check on the management fund, do you say that the trustee

companies, as they now exist, do not provide any check at all or do not provide sufficient a check to justify the money they are paid?

Ms Ralph—I do not think it is the case that they do not provide anything. I think what we have here is a choice between two systems. The conclusion that we have come to after eight years is that the single responsible entity regime, based on sheeting home accountability—an onerous accountability—to those people whose behaviour you are trying to effect, is the most effective way to minimise risk, as opposed to a two-tier system, which is rather like a parent watching a child.

I guess the conclusion that we have come to is that a system based on corporate governance, similar to what we have in SIS, and the corporations law is really the best way to create that climate of compliance, which Alan Cameron was talking about, to affect the behaviour of those people who are responsible for the money and to make sure that they initiate and manage the controls and systems in the way to minimise risk. That is the conclusion we have come to.

Senator COONEY—Under your system, who supervises the working of that system?

Ms Ralph—The directors who are responsible for the single responsible entity.

Senator COONEY—But they are the directors of the company, aren't they? They are internal to the company?

Ms Ralph—Yes. It is like asking: who supervises a corporation? The board of directors.

Senator COONEY—You give that answer. But they are supervised by the general law in the sense that people can go off and get injunctions, and what have you. We heard Mr Cameron talking about that. With the sorts of things we are talking about here, are we not talking about small investors? I think there is a difference between small investors trying to enforce their rights and larger investors, such as institutional investors, trying to enforce their rights. So I think there is a different situation; or do you say there is not?

Ms Ralph—Of course, there is a different situation. But I guess what I am saying is that what we are trying to do under this regime is create the climate of compliance in the funds management industry, affect the conduct of the people in the industry. The best way to do that, we believe, is to sheet the accountability home to those people clearly, concisely and in an intense fashion. We think that is what this bill does.

Senator COONEY—You do not think there is any significance in the fact that you have small investors who, ultimately, if they want to get an injunction, a mandamus or sue a contractor, do not have the resources to do that? Does that not really matter?

Ms Ralph—No, I do not think that is what we are saying.

Mr Hawkey—But none of those rights are removed by this legislation.

Senator COONEY—Of course, that is what I am saying. But it is the enforcement of the rights. It seems to me that what you are doing is saying, 'These rights will remain, therefore it is all right,' without looking at the ability of the people who invest, the small investors, to enforce those rights. You do not seem to want to come at that.

Mr Hawkey—I believe one of the things we can really judge harshly in terms of the past regime is that there has not been an ability for small investors to take action. As Mr Cameron has outlined, we do now have an ability for the regulator to assess those situations and take action on behalf of the investors. We have not had that in the past. We are talking about a regime where the very concern you are indicating is, in reality, dealt with by this legislation, where it has not been in the past.

Ms Howard—The regulator would have the power that the ACCC has to obtain enforceable undertakings which, from Professor Fels's management of that legislation, would appear to be a quite effective means of enforcing the legislation. I think your point is quite strong, Senator. But the way the system is at the present time, investors are in no better position. They would still have to seek mandamus and that sort of thing, which is a costly legal expense. A proper complaints system, where their complaint is dealt with in a non-confrontational mediation fashion is the best method.

Mr Mason—Could I make one further comment? The question of whether a trustee under the current arrangements, with its trustee duties, ought to proceed against the management company in respect of a single matter affecting a single investor, possibly for the kind of money that you are talking about, is by no means clear. The trustee's obligation is to the investors as a whole, and it is to consider whether it is appropriate to take that action. For any number of reasons, it may well conclude that, basically, it is too expensive for one of those reasons. The more effective and much more direct mechanism, it seems to me, is to set up these systems within the entity where they try to resolve the difficulty directly with the person who has raised it.

In many cases there is no real difficulty; it is simply a question of a lack of information or a lack of understanding. Once the thing is explained to the investor—

Senator COONEY—Are there investors' representatives on these internal tribunals?

Mr Mason—The usual mechanism—we follow the superannuation model and what has happened in superannuation funds. It is like the government systems; it is reviewed by different officers. Decisions are reviewed in that sense so that you get another fresh mind looking at the problem.

CHAIR—If there are no further questions from members of the committee, Senator Murray has tabled some questions on notice which he would like IFSA to respond to, obviously as quickly as possible because there is a short time frame for consideration of the bill by the committee.

Mr Mason—Yes.

CHAIR—I will arrange for the secretariat to get those questions to you very promptly. I thank you for your patience in appearing before the committee in two broken-up segments, for the time you have given us and the way in which you have answered questions.

[5.27 p.m.]

ROFE, Mr Alfred Edward Fulton, Chairman, Australian Shareholder's Association, GPO Box 5210, Sydney, New South Wales 2001

CHAIR—Welcome. Would you care to make an opening statement in relation to your submission?

Mr Rofe—Yes, if I may, Mr Chairman. Just one preliminary point: I notice that one of the first speakers regretted that there was only one investor represented here today. The situation is not quite as bad as that, I do not think. Although our association is called the Australian Shareholders Association, that is an historical anomaly. That was what it was called 30 years ago, when it was formed, but we do represent the interests of investors in all sorts of financial securities, including managed funds.

Another point I might make is that from 1994 to 1997 I was a member of the Corporations Law Simplification Consultative Group, so I have some knowledge of the extensive consultation which took place in relation to the first draft of this bill. I must say I share somewhat the view expressed earlier by Lynn Ralph that this issue of a dual structure versus a single responsible entity has been debated for many years now. The original bill was introduced by the former government; the present bill has been introduced by this government. So I would have thought that the issue of whether or not we need a trustee has had a pretty thorough airing. My feeling is that it would be in everyone's interests to get on with it and get the bill enacted and in operation.

There are a few points of finetuning, which a number of people here have raised. But the basic structure has been debated at some length. Looking at the timetable for these discussions today, I see some 60 minutes was allocated for the trustees, some 50 minutes for the funds managers and 7½ minutes for each of the two representatives of investors. I think it is typical of the way this debate has been conducted—that, in this sort of power struggle between the trustees and the fund managers, the interests of investors have really been overlooked. The two groups say they are there to protect the interests of investors, but the practical questions about the interests of investors, as I say, have been overlooked. I think the problem with the previous legislation was that neither the trustees nor the fund managers were in fact properly accountable to investors.

I would ask that our written submission be incorporated in the transcript to save time reading it.

CHAIR—Is it the wish of the committee that the submission be incorporated? There being no objection, it is so ordered. It will appear in a separate volume.

Mr Rofe—If I may then highlight a couple of points and comment on some of the other points that have been raised. Clearly we support the concept of the single responsible entity. Secondly, we support the removal of the requirement for a compulsory custodian. These issues have already been raised, but I think there are two key things—first of all, by having a statutory custodian you would reintroduce the question of who exactly is responsible for what. I think having a single responsible entity focuses the question of responsibility and

then it is up to the responsible entity what they do about appointing custodians or not. As Mr Bradley has pointed out, and as I think most people agree, from the point of view of administrative convenience apart from anything else, most funds will continue to have custodians. They may well be in many cases in-house custodians, but I do not think that is a problem.

The other main point is that I think it is appropriate to leave it to the market. If fund managers find they cannot raise funds unless they have a separate custodian, they will have a custodian. If they find problems with competing with overseas institutions because they do not have a custodian, or indeed a trustee, they can have one under the present bill. So, as I say, I would leave it to the market, and there is always the fall-back position under section 601QA, where, in the case of an ostrich farm or something like that, the ASC can insist on a separate custodian.

Many of our fund managers nowadays—BT Australia, AMP, National Mutual, Lend Lease—are bigger than most of our trustee companies or our custodians. I think if you cannot have confidence in their in-house custodian, if they choose to have one, I cannot really see that you are going to be any better off by appointing a custodian or a trustee. Even the Perpetual Trustee tell us that they do not need a separate custodian for some of their funds. In the case of the ostrich farms, the ASC may well say let us have a custodian.

On the question of accountability to investors, I think that is a problem. I do not think it is sufficient to say—and, in fact, the legislation does not use the term—'independent directors'; the legislation talks about 'external directors'. If you look at the situation of external directors on the board of a fund's management company: who are they appointed by, and who can they be removed by? Not by the investors, but by the group itself or their shareholders. Who are the members of the compliance committee appointed by? It is by the funds manager. It is no good just saying you have 'independent directors'. You have got to have directors who are capable and who have the power, the willingness and the ability to act independently. That is why we support the idea of a compliance committee, elected—appointed—by the investors.

I seek leave to table a document. It is the charter of the supervisory board of the General Property Trust. This supervisory board has many of the characteristics of a compliance committee, but the point is that a majority of the members are appointed by the investors. I am not saying that it is the perfect answer, but I am suggesting it is an example which shows that it is possible to have a supervisory board or a compliance committee, whatever you call it, appointed by and accountable to the investors—the people whose money is ultimately at risk.

I will just run through some of the other points. We have said in our submission that a registered scheme which is a disclosing entity should be required to hold annual general meetings in the same manner as a public company. I think it might have been Mr Cameron who said that funds investment schemes are not the same as public companies, but if you look at some of our major funds, they are not really very different—particularly the ones listed on the stock exchange. They are just an alternative form of investment. It is arguable that the same sort of principles of corporate governance and of accountability to investors

should apply to them in the same way as they apply to other companies which raise money from the public.

The annual report of a registered scheme which is a disclosing entity should be laid before the annual general meeting of the scheme. Again, this is a question of accountability to investors. The opportunity to ask questions about the accounts and to ask questions of the supervisory board or the compliance committee is very important. We are having hearings here today so that there can be an asking of questions, an interchange of ideas. I am sure sometimes it would be great if parliament never sat and the executive government was left to run the country, but I do not think people would really accept it in the long run, would they? Meeting together is a very important mechanism, even though individual voices may not count for very much.

We have suggested that amendments to the constitution and compliance plan should be subject to approval by the members of the scheme in the same way as amendments of the constitution of a company are subject to approval by the members of the company. Again, some of the problems of the 1980s arose from amendments to trust deeds which were signed off by the trustee, but which were never even notified to the investors—let alone their approval sought. If you have an independent compliance committee, it may be appropriate for the compliance committee to approve routine amendments to the constitution or the compliance plan. But I think if there are major changes in the structure of the constitution—on the basis of which people have invested their money—that investors should have the right to say yes or no to any fundamental change to that document.

I have said that a registered scheme which is a disclosing entity should be required to have a compliance committee accountable to the members and the majority of the members should be appointed by and subject to removal by the members of the scheme. The auditors of the scheme should report to the members of the scheme and should be appointed by and subject to removal by the members of the scheme.

Let me stop here for a moment to make a point about auditors, because I think there can be some confusion here. There is a requirement under the Corporations Law for the responsible entity to have its own financial statements audited. There is a requirement to have the financial statements of the scheme itself audited and there is a requirement under the bill for an audit of the compliance plan. What I am saying here is that there is no objection to the same person acting as auditor of the scheme accounts and of the compliance plan. Indeed, I think it would be an advantage, a cost saving, for the same auditor to do both jobs, because they are both a question of reporting to the investors.

There is a separate issue of whether that one auditor should also be the auditor of the responsible entity itself. I have an open mind on that. The solution in the bill that says they have to be different people but can both work for the same firm is a charade. Either they are independent or they are not independent. Personally, I would be inclined to leave it to the accounting bodies and the Auditing Standards Board to address this question of independence. But, as I say, I have an open mind. Certainly, as far as the audit of the compliance plan and the audit of the scheme accounts are concerned, they should be carried out by one auditor.

There are a number of other points. The question of the liability of officers and directors of a responsible entity to the members of the scheme has been raised. I was interested in Alan Cameron's comment about a possible derivative action there. It seems to me that the problem here is very similar to the Foss v. Harbottle problem in relation to companies. If a director or an officer of the company acts in some way which prejudices investors' interests, and the company itself fails to take action, what rights have the investors? The same question might arise here. I think it is something that should be clarified in the bill, and I think Alan's suggestion might be the right way to go about it.

There is a schedule attached to our submission which details a number of drafting matters. I will not say anything about those. I think it was Mr Thomson who referred to a list of amendments to the legislation which the trustee companies had suggested were required. He invited IFSA to comment. I think they said that they had covered it in their submission. I would certainly be happy to comment, but I am not sure whether you want to spend time doing that.

CHAIR—We could take a very few minutes. If you think it is going to take more than two or three minutes, it might suffice if you put it in writing to the committee.

Mr Rofe—In view of the shortage of time and the fact that there is another bill, that might be the best way to go about it.

CHAIR—Will you be able to do that reasonably promptly for us?

Mr Rofe—Yes.

CHAIR—In the light of your experience over the last 10 years, do you think the existing two-party system has failed investors?

Mr Rofe—I think it has. One point the trustee companies have made is that, in the case of these two major loss situations, ultimately the trustee companies did pay up some money; but they had to be dragged through the courts to do so. You might say, 'If your house burns down, it is nice to be able to go and get a cheque from the insurance company.' But surely it is a lot better to have some smoke detectors and a fire brigade or something like that to stop the fire before it gets out of control, rather than looking for a trustee company to pay the bill at the end?' Trying to stop problems before they happen is more important than asking a trustee company to pay up at the end. Again, about the role of trustees in protecting investors, I cannot think of one of these recent cases where the trustee has actually sued on behalf of the investors to recover money. It has always been the case of someone suing the trustees, as far as I can remember.

CHAIR—In terms of the legislation before us and the flexible framework for regulation that that provides, do you believe that that will improve investor protection and also reduce compliance costs?

Mr Rofe—I believe that it should. I believe that knowing who is responsible is a step forward. Of course, I think quite a lot will fall back on the ASC in these policy statements and how it goes through the approval process.

But I will say one thing there which, I guess, is a view to some extent I share with the trustee companies. They make the point that the bill places excessive reliance on the regulator to monitor and enforce the responsibilities in performance obligations, rather than facilitating self-help by investors; and it says that 'the bill relies on a high level of government supervision and enforcement to protect investors' and 'moving these responsibilities, the regulator will require ultimately that those activities be funded from the public purse'.

I think that is a valid point. I think it would be better and more in conformance with the idea of less regulation rather than more to facilitate the monitoring by investors, by a compliance committee, of the activities of fund managers, rather than relying on the regulator to do so.

Senator COONEY—Do you speak for all investors? You may have heard me before on small investors and large investors. Could you qualify yourself and tell us who you represent?

Mr Rofe—I suppose I would say that we purport to speak for individual investors as distinct from institutional investors.

Senator MURRAY—Mr Rofe, as you know, the Senate is the house of review. I see from the time line that there has been a nine-year gestation period. The first time the Senate got its hands on it was in March 1998; it was referred last week; we are having a committee hearing today; and the report is due out next week. So I would just remind all listeners that the Senate is moving exceptionally swiftly with this, but we have to fulfil our role as a house of review.

If you have been here all day, I think you would be aware that the focus is not on the provisions of the bill in terms of efficiency, cost or new and modern systems which have been developed through this nine-year process. The focus is just on concern as to whether there is sufficient and arms-length protection of investors. You have indicated some weaknesses that you and your association perceive and, secondly, what the future role of trustee type proposals, plans or operations should be. These trustee companies have massive funds; they are big players in the market already.

Mr Rofe—Some of the funds managers are too though.

Senator MURRAY—Yes, I understand that. I would really like your view as to what you think the future role of trustees would be under this new regime.

Mr Rofe—I think certainly some of the trustee companies—and Mr Bradley's company is probably as good an example as any—have developed quite an expertise in the custodianship function and, as I said, I think a lot of funds managers will want to voluntarily engage custodians. I think there will be some cases where people will not be able to raise funds—perhaps because they are not well known—without engaging someone like a trustee company to act as custodian. But what I am saying is that I think it is appropriate to leave it to the market to make that choice.

Senator MURRAY—The proposition put is that the trustee system provides an extra arm, if you like, of protection—and I appreciate the contrary view that has been put today. But there may be many investors who would still appreciate that role and would choose it.

The assumption though that I and other senators, and perhaps other members, have is that many investors do not have the capacity to make that voluntary choice and would benefit from a situation in which the two choices were presented to them. How would you see that happening in the marketplace if there were not a provision in the legislation to oblige that to happen?

Mr Rofe—I must say, I have been concerned at some of the remarks that have been made today in a somewhat derogatory sense about 'mum and dad investors'. If you look at the statistics, if you look at the increase in the number of people who are investing in financial securities these days—and I think you can look at their intelligence of them—I think they are not all that stupid, really.

The other thing is that, rather than saying we should appoint some sort of paternalistic either ASC or trustee company to look after their interests, I think a more positive approach is to educate the investors. If Alan Cameron had been here a bit longer and you had asked him about this, he would have said something about what the ASC has been doing to educate investors, to draw their attention to some of the risks of some of these tax schemes, and so forth.

CHAIR—As recently as last night in Adelaide.

Mr Rofe—I am sure he did. The other thing that he might have mentioned is the role of the ASC in relation to investment advisers. If you feel sick, you go to a doctor or someone to give you a bit of advice, don't you? I would suggest that an increasing number of people, if they want to invest some money, do not just pick it with a pin but go along to an investment adviser. Educating investors, improving the quality of investment advice that people receive, I think, is probably a better long-term strategy than saying, 'Poor old mum and dad, they can't look after themselves; we'll have to have the trustee company there to manage their affairs.'

Senator MURRAY—I understand the direction you are going in. But you would appreciate that economists are damned for all time for commencing their theoretical models with the words 'assume perfect knowledge' of one kind or another. We can never assume perfect knowledge in the investor community either. Really, it is just our job as legislators to provide as much as we can to protect people from losing their money. That is why there is regulation—because there is not a perfect market. You and everyone else has accepted that because the ASC's role is there, the legislation is there and the fund manager's role is there.

But you can hear from the questioning from some of us that we are not satisfied that there is sufficient protection. Do you think there would be a particular time period after which a review of this bill would be appropriate to determine whether there had been significant weaknesses emerging from it?

Mr Rofe—I think it is probably appropriate for all legislation to be reviewed from time to time, because the environment changes.

Senator MURRAY—Is there a time frame in investment life though which is relevant—three years or five years? What is the framework in which you will discover problems?

Mr Rofe—I would say that, if you were going to review this legislation, you would want to leave it five years, I think. You have a two-year transition period. You are going to have a settling in period before you really know. People have said, 'Well, we've had the SIS legislation in force'—but really you cannot make final conclusions about that. So I would think you would want perhaps five years at least to review the new legislation.

CHAIR—Mr Rofe, I thank you for your presentation to us and answers to questions. If you would put that other material to us in writing, we would be most appreciative.

Mr Rofe—I will do that.

CHAIR—That concludes our hearing, as far as the Managed Investments Bill 1997is concerned. It has been a bit of a marathon and certainly has taken longer than was programmed. But I think the discussion that we have had has been very informative and worthwhile. We will now move to the Company Law Review Bill 1997. I therefore close the hearing on the Managed Investments Bill 1997.

Committee adjourned at 5.50 p.m.