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JOINT COMMITTEE on CORPORATIONS AND SECURITIES

Reference: Managed Investments Bill 1997

TUESDAY, 24 MARCH 1998

CANBERRA

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SENATE

TUESDAY, 24 MARCH 1998

JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Members: Senator Chapman *(Chair)*, Mr Anthony, Mrs Johnston, Mrs De-Anne Kelly, Mr Leo McLeay and Mr Kelvin Thomson and Senators Conroy, Cooney, Gibson and Murray

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

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

Managed Investments Bill 1997

WITNESSES

Committee met at 8.41 p.m.

ADAMS, Mr Mark Leigh, Principal Legal Officer, Regulatory Policy Branch, Australian Securities Commislsion, 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 Commission, GPO Box 9827, Canberra, Australian Capital Territory

CHAIR—I declare open the public hearing of the Parliamentary Joint Committee on Corporations and Securities and welcome the Australian Securities Commission as the first group of witnesses. Do you wish to make an opening statement.

Ms Segal—No, we are here to answer your questions.

CHAIR—I understood that there were some questions from opposition members of the committee.

Mr KELVIN THOMSON—The first issue is: I take it you have had the opportunity to go over a lot of the objections that we have heard to the managed investments bill and the fact that the committee has received many submissions expressing concerns, doubts, reservations about whether this is going to work, whether the investor protection is adequate, and so on. It does strike me, and it strikes others, that you are in a pivotal roll in relation to all this. So, have you seen all those objections and expressions of concern, and if so, what is your response to them?

Ms Segal—We certainly have had the opportunity to read some of the submissions, I cannot be sure we have seen all of them, but certainly I think we understand the nature of the concerns that have been expressed. As I think Mr Cameron said last time, we view the bill as taking an approach which is looking forward to where we think legislation should be going—and that is an outcomes approach. It requires a mixture of things to be taken into account, not only the legislation but the policies and the implementation of the legislation, and we think that if we combine the framework plus the ASC's proposed policies—which will include custodial standards, licensing requirements, registration, all of those things that Mr Cameron listed—that will mean that investor protection will be appropriate. I think that is the crux of some of the issues that were put before you and obviously something that we are all concerned about in terms of investor protection. It is our view that the combination that we are speaking about will mean that that investor protection will be appropriate.

Mr KELVIN THOMSON—And that the dire predictions of those who are opposed to the legislation will not come to pass.

Ms Segal—Well, we certainly hope that to be the case.

Mr KELVIN THOMSON—We need to do a little more than hope don't we? In order to pass judgment on the bill, we have to satisfy ourselves that—

Ms Segal—Sure. I think that it is very hard to guarantee things but perhaps if we talk about some of our thoughts about it, that includes things like custodial standards. It includes things like capital requirements, and part of that will include a proposal that there be forward insurance. Those sorts of things we believe will deal with any issues that might arise.

Mr KELVIN THOMSON—I was trying to make my way through your contribution at the earlier hearing, but I think I missed it due to having to speak elsewhere. What are you saying about the capital adequacy issue and concerns?

Ms Segal—As I think Mr Cameron mentioned, the ASC is in the process of putting together some proposals to put out there, to consult with industry and to hear people's comments on them. But our thinking at the moment is that it is important and appropriate to set financial resource requirements. We want to set these at both the responsible entity level and at the custodian level. I will run through it to give you a picture of where our thinking goes. Perhaps I should outline why we think it is necessary, and it probably will accord with your thoughts.

We need to have a responsible entities commitment to the operation of a scheme, which will include the capacity perhaps to transfer scheme property. We need to have some protection against institutional and fraud risk, and we need to have some jurisdictional consistency with other jurisdictions and with the SIS legislation. We need to combine the thinking that there will be a range of schemes. We are not just dealing with the large end of town but with some smaller schemes. They can range in nature from very large investment schemes—from an equity fund offered by a subsidiary of a bank to a smaller agricultural scheme. That is why the policy needs to have a degree of flexibility in it. The minimum capital requirements that we are looking at will cover protection from failure or collapse, will cover the capital required to demonstrate commitment and will cover the professional indemnity insurance and insurance against fraud that I mentioned earlier.

This translates to: where a responsible entity operates a predominantly liquid scheme, you will note that liquidity has greater risk because assets can be disposed of more easily. We are thinking that one has to look at the schemes according to the assets, so where a responsible entity operates a predominantly liquid scheme, either the responsible entity or the custodial agent, if it is not a self-custody fund, will be required to have surplus liquid assets of about $5 million. I stress that these are our thoughts that we want to put out for discussion.

Where the responsible entity operates a predominantly liquid scheme, in addition to the custodial requirements the responsible entity should, as a demonstration of its own commitment to the operation of the scheme, have surplus liquid funds of about five per cent of the

value of the assets, subject to a minimum, perhaps, of $100,000 and a maximum of $5 million. So you have got the custodian with its capital requirements and you have got the responsible entity.

Where there is an 'illiquid' scheme—and the risks will be different—the responsible entity will be required to have surplus liquid funds of $100,000. That predominantly 'illiquid' scheme is at the smaller end of the market—the agricultural schemes. We think that that is the appropriate level. We think that the responsible entity should have some level of professional indemnity insurance and fraud insurance, because the risk of fraud is not something that might be dealt with in the ordinary way. We have taken into account the situation overseas and the situation with SIS. We think that this pitches it at an appropriate level.

Mr KELVIN THOMSON—There is not much new under the sun in this debate, but I read an article recently which talked about a different impact of this legislation on the larger funds which have extensive checking, monitoring and so on requirements of their own and, according to the article, do not need the supervision of a trustee or anything of that nature compared with the smaller funds which do not have those sorts of arrangements in place and for whom taking out the trustee might involve some burden on them or some necessity to make appropriate alternative arrangements. To what extent do you think that you are capable of drawing up guidelines and practices based on the fact that one size is not going to fit all?

Ms Segal—You have hit the nail on the head because that is exactly what I think this bill and our policy proposal would do. It would not have an inflexible arrangement but allow the policies to apply in an appropriate fashion. In our thinking on the compliance policy, we will suggest that it is the outcome that we are focused on, and not a checklist and a set of mandatory requirements but a demonstration to the ASC that the fund has considered the risks and has put in place appropriate processes to deal with those risks.

A very large fund will have staff and processes. A smaller fund still needs to deal with the risks. It might be smaller because it has illiquid assets. It might be smaller just because it has fewer assets. Therefore, the processes that smaller funds need to go through will be less costly for them but, nevertheless, need to be sufficient to deal with compliance. Whilst there is flexibility, there will be some fundamentals in terms of compliance that need to be satisfied. If a smaller fund is not in compliance and is not looking at making sure that investment policies and so on are appropriate, it might need to lift its game. On the other hand, it will only need to do what is sufficient to deal with its risks.

Mr KELVIN THOMSON—Concerns have been expressed to us about the capacity of the ASC to deal with this issue on a number of grounds. One of them is resources. Your staff numbers fell from 1,398 at 30 June 1996 to 1,191 at 30 June 1997. Funding cuts also accompanied that. The question in our minds is: will you have the resources to do the job and pick up the extra load which you are being expected to pick up?

Ms Segal—Obviously, the ASC has considered the additional processes that it will be putting in place, has made the government aware of its needs and has put in its request for funds as part of the budgetary process. I can only say that that is still in process. We await the announcement of the budget, as all of you do. We feel that we will be able to deliver. I can only say that, if resources are inadequate, we will certainly be going back to the government and letting them know. It is an annual process. We think that certainly in the first year there will be resources. If they are inadequate, we will not be backward in coming forward.

Mr KELVIN THOMSON—There is a problem: the horse may have bolted in terms of the legislation. The argument for the role of trustees is based around the idea that they are needed and that you will not be able to fill that gap. If you are not able to talk about resources into the future, it is a bit hard for us to deal with that, given that the bill is up for consideration right now.

Ms Segal—I reiterate something that Mr Cameron said last time and that is that the ASC is not replacing trustees. It is the panoply that is the replacement. The bill itself has a large number of features in it which deal with the protection. The ASC is coming in and, in some senses, putting out new policies and will be supervising compliance by requiring compliance plans and so on. It does some of that already. It does license entities. It is not as if we are starting from a zero base.

Mr LEO McLEAY—You will be seen by investors, particularly small investors, as replacing the trustee. That would be their impression. If this scheme is going to work properly and this piece of legislation is going to provide some sort of certainty, that impression has to be met, doesn't it?

Ms Segal—I think that the ASC has to deliver in terms of being adequately resourced, and not only financially resourced but in terms of its own people. It has to be geared up to deal with the licensing, the registration and the compliance element, which is the key to having the schemes come within the new bill. As I say, the detail is subject to the budget.

I can only say that perhaps Treasury might be in a position to give you greater detail. We are gearing up to do it. We feel if we are in the immediate term short of resources we will be able to move resources, certainly in the short term and medium term, from other areas. Then we will be able to communicate if resources are inadequate.

Mr LEO McLEAY—Do you think you will need more resources to deal with this legislation than you have now to deal with what you are doing?

Ms Segal—Yes. I think it is fair to say this will take additional resources because we will be requiring compliance plans of every fund and be subjecting them to some scrutiny. Whilst we are not taking a sort of check list, very detailed approach that we have to understand everything, we still will have to go through the compliance process to make sure that funds understand their own compliance system. We will be dealing with, I think, the

transition and the modifications to move into the new system so it will take additional people and we have made our needs known.

Mr LEO McLEAY—What type of additional resourcing? What quantum are we looking at here?

Ms Segal—I think that the sort of overall quantum of people and resources is the matter of the entire ASC budget. I am not sure it would be appropriate to talk about that in that sort of detail given the fact that we are in the budgetary process. Once the budget is down we will be more than happy to talk the detail but I think given where we are that is probably subject to the budget.

Mr LEO McLEAY—Except that we are supposed to report to the parliament within days about this piece of legislation. You tell us that you believe the ASC will need more resources to carry out its role under this new piece of legislation. Surely somewhere or other you have considered what level of resourcing that will require. You have already said that you agree that small investors, and maybe even medium sized investors, will see you as taking a role that the trustee may have taken. Surely you have considered this and what sort of level of additional resources you are looking at the ASC putting into this? What would be your wish list? It might not necessarily be what the budgetary process provides but surely you have some thought in your mind.

Ms Segal—Can I say that whilst the ASC obviously has put forward its plans I can only repeat that I think it is really subject to the budgetary process. The ASC has taken some comfort, I think, or can take comfort from some of the comments made last time. There is this proposal that the industry itself would be happy to contribute if need be through a levy. I know that there is a review proposed in the bill itself to look at its workings and obviously at resources and so on after a period of a couple of years. I think there are a number of protections in there. I do not feel that it is quite as at large perhaps as you are suggesting.

Mr LEO McLEAY—You said at the beginning you thought you would need more. Now you are telling me you do not think it will be as large as what you thought at the beginning?

Ms Segal—No, I did not say it would be 'as large'. I am sorry. I did not say it would be large. I just do not think it is 'at large'. I think that there are a number of measures in there which will ensure that there are resources available. I just cannot tell you at this point what resources will be available because it is still subject to the budget process, but I think the government has an understanding of what is needed. I can only say that we expect that those resources will be available and if they are not we will not be backward in coming forward.

Senator GIBSON—Ms Segal, there have been suggestions that the custodian should be made independent and that should be mandatory. Will that increase investor protection?

Ms Segal—I do not think that a mandatory custodian will necessarily increase investor protection. I think that, as might have been pointed out by Mr Cameron last time, the need

for flexibility which the bill provides at the moment is probably the best approach for investor protection as suggested by the Law Reform Commission, by CASAC and by Wallis. As I understand, the thrust of their proposals is that if there is a mandatory custodian you have the risk of confusion. But on the other hand our policies will very carefully set down custodial standards and it is only the responsible entity that is going to be able to satisfy those custodial standards; that will be a self-custodian.

In many cases, those custodial obligations will be outsourced and present trustees and other professional custodians will act as those custodians because it is mandated in the bill that scheme property be kept separate and independent, and that standard will need to be met. To answer your question, I think that in some cases a separate custodian will be necessary and, in other cases, the flexibility to have a self-custodian will probably lead to a more efficient set-up.

Senator GIBSON—The bill allows for a custodian to be set up as independent from the single responsible entity. Will existing trustee companies be able to fulfil that role?

Ms Segal—Yes, absolutely. Existing trustees and existing professional custodians will certainly be able to do that.

Senator MURRAY—Firstly, Mr Tanzer, I would like to thank you for your response to my questions on notice. I have gone through it and it is very helpful. I appreciate that. Ms Segal, I wonder whether you could clarify something for me because I pricked up my ears and I might have misunderstood. What I understood you to say just then—and maybe you did not—was that ASC is considering a proposal to charge a cost for its services in this area.

Ms Segal—No.

Senator MURRAY—You said you would go to the industry and recover costs and they will come to the party.

Ms Segal—That is wishful thinking, I think. No, I just said in answer that IFSA, at the last hearing, had indicated that the industry would be interested in or supportive of various mechanisms—whether it was a levy or whatever it is. I said that that matter had been put before the committee in terms of future funding for the entire process. I am not saying that it is in any way presently within anybody's intention or certainly within the ASC's power but that it was a statement by the industry that they were happy to pay, if necessary, for this entire new process and development because they saw it as positive and as something that was within their purview. Perhaps that is something to clarify further with the IFSA people. That was just my understanding of what they said.

Senator MURRAY—Let us assume that offer was taken up. I presume the government would be the ones who would make that decision?

Ms Segal—Absolutely.

Senator MURRAY—Let us assume they did not give you enough money or resources to employ enough people or have the funds to employ the quality of people or have the technology or whatever to pursue this and the ASC had to get those funds from a section of the industry to maintain a division or a department. Is there not a danger, if that happened, that that division or department would be a captive of that industry? You know the old thing about he who plays the piper calls the tune.

Ms Segal—It is very hard to speculate, at this point, how such a levy might be constructed. I think it is important to ensure that the ASC obviously maintains its independence. As somebody who has come to the ASC fairly recently, I am struck with and constantly impressed by the quality of the people within the ASC. I know it is a little tangential but I think that is a very real thing to remember. The people in there have very high standards of independence and integrity and take their work, as within the regulator, very seriously.

Senator MURRAY—Have you seen any staff profile for the ASC which is a typical demographic, if you like, of the ASC?

Ms Segal—I have, I suppose, an understanding of the staff. I do not know about a full demographic.

Senator MURRAY—What I am asking you is whether you have any knowledge of the average time in which the average staff member has been within the ASC?

Ms Segal—Yes, I have some knowledge of that.

Senator MURRAY—Could you give me an idea of the years?

Ms Segal—I think the ASC has an interesting mix of people, some of whom have been there for some time, and who came to the ASC when the ASC was formed from the corporate affairs commissions. It also has a large number of newer people who have been recruited from industry, from the professions. It has a mix of people rather than an average, if I could use that word.

Senator MURRAY—The ASC people I have met are very high quality and capable people. However, remarks have been made to the committee that the ASC cannot pay top dollar for the very best people in the field by nature of it being an institution; that the corporate memory is relatively short because of fairly rapid turnover—once people get on their way with their careers they move on to bigger dollars—and that the staff turnover could result in some lack of continuity in the regulatory role. I am not in a position to judge whether that is so but it would imply a lesser capability than, say, a standard fund manager organisation which might be paying top dollar or a standard trustee corporation which might be paying top dollar.

Ms Segal—I would take issue with that, quite strongly. I think it is important to have corporate memory in any organisation. My view of the ASC to date is that there is enough corporate memory. I think top dollar is an ambiguous expression because people join an organisation like the ASC not just for the money but because they value the work that it does and they feel quite committed to it. I think the ASC has some exceptional people. They join provided they are paid a reasonable dollar, but they are committed to the work. I have seen some very outstanding intellects.

I think that organisations need a measure of change. A measure of new blood is important particularly in a regulator that has to keep up to date with the market and with the players that are in the market. People who have had experience in the market, people who have come from industry, people who have worked overseas and have an understanding of what other regulators are doing, all add to the complex and the matrix that make for a sophisticated, knowledgeable and responsive regulator. That is what we see ourselves doing.

Senator MURRAY—Thank you. Is the ASC at present capable of being sued by investors for breaches of fiduciary duty or duty of care?

Mr Tanzer—I think the answer would be under section 248 of the ASC law. Officers and the commission itself have the same sorts of indemnities from those sorts of actions as other Commonwealth regulatory agencies have, which is to say that unless the commission is acting in 'bad faith' an action does not lie. It would depend on whether the action that you are speaking of would fall within that formulation. I really should not speculate, I guess. We have not been in the situation where we have been sued for negligence or it has never been tested in the sense of whether mere negligence would be sufficient to say that you had acted in bad faith and therefore an action would lie. But, essentially, 248 provides the same indemnities as apply to other—

Senator MURRAY—And the new bill carries forward that indemnity, does it not?

Mr Tanzer—This bill does not affect it. It sits within the ASC law itself.

Senator MURRAY—Yes, so the same indemnity applies?

Mr Tanzer—Yes.

Senator MURRAY—Whereas formerly the investors could at least sue two out of three parties—the trustees and the fund managers—now they may be in the situation where they can only sue the single responsible entity. That would be so, would it not?

Ms Segal—Yes.

Mr Tanzer—On the assumption that the manager had not appointed a custodian, that is right, but the thesis behind the bill is that there is a single responsible entity and that therefore you sue that person.

Ms Segal—And that the lines of responsibility are clear, so that the responsible entity knows their obligations and they are the ones who then would be sued.

Senator MURRAY—So the point rightly made by my colleagues earlier, that the ASC cannot be in any respect regarded as a substitute for a custodian or a trustee or in any sense adopt that role, would be so? Those small investors, particularly, who might be under that misapprehension, would be entirely under a misapprehension?

Mr Tanzer—I think that, as the situation stands at present, investors can look to the manager and they can look to the trustee. That is primarily who they would look to. In the case where there was a failure by either or both of those, they might well lodge a complaint with the ASC about the matter. Under the new bill, as I understand it, it will be unambiguously clear that they look to the single responsible entity.

The value in suing two people rather than suing one is a matter for others to judge. Certainly the thesis behind the bill—and I gather this was part of the motivation behind the recommendations of the Law Reform Commission, the Companies and Securities Advisory Committee and the Wallis committee—was that there was value in actually making it unambiguously clear, not only for the entities concerned but for the investors.

Ms Segal—It is important also—this deals with the question earlier about the small investors perhaps seeing the ASC as a substitute—that there be a measure of education, as I think there will be as things develop. I do not think it is too different from the SIS position at present. It is a matter of individuals and investors understanding what are their rights, what are their obligations and, if they have problems, how they might lodge the complaints. That is all part of the bill—as I said, the panoply. The bill deals with a lot of those issues and it is important that they then understand the situation. If they are under a misapprehension that will be corrected.

Senator MURRAY—It has been put to me by some very capable people that the ASC simply substitutes for trustees. In my view there have been three roles in which that should be judged. The first is what we have just discussed, the ability to be sued, and plainly you cannot. The second is the ability to protect the investors' money at least as well as trustees do, and I guess that is open to judgment. The third is whether you can grow and improve investors' funds as well as trustees do. On those latter two do you have any comment?

Ms Segal—I will just take your last point, the growth of funds. It is really a difficult question as to whether the trustees are responsible for the growth of the fund or whether the manager is responsible for the growth of the fund.

Senator MURRAY—Trustees claim both, of course, and fund managers definitely claim neither.

Ms Segal—It is really for the committee to inform itself, perhaps from some of the representatives here, but in many cases the role of the trustee, even as they define it themselves in some of the trust deeds, is not necessarily to do that. Certainly the arguments that I have seen in the submissions did not have them deal with the growth of the fund. They dealt with the protective side of things. So I think the growth is a problematic proposition, if I could put it that way.

Coming back to the protection role, I think that all that has been stated by the various reports, committees and the Wallis recommendation: the proposal behind the bill is that the single responsible entity will enable the rights, obligations and duties to be clearer and that lack of confusion will, indeed, itself add to investor protection. Because of the nature of the legislation and the thinking of it, that it is outcomes based, it is necessary for the ASC to put out policies dealing with how it will fulfil its role in ensuring that the managers have considered appropriate compliance proposals, that there are appropriate custodial standards.

It is not that they are stepping into the role, but that the elements that are seen as appropriate today for investor protection are dealt with—and that they are not just dealt with by the ASC but by the single responsible entity having these policies in place: having capital adequacy requirements, possibly having fraud insurance, having in place a custodian if appropriate, or custodial standards if they are going to be a self-custodian. So it is the mixture that will deliver to the investor. I think that when that has been explained out there—there will be a measure of education that is necessary, but there has been education in superannuation and I think the investing public are very much more aware today than they have been in the past, and that will need to continue here—it is the mixture of all of that that will deliver the package.

CHAIR—I thank the officers of the ASC for their appearance tonight.

[9.17 p.m.]

BRADLEY, Mr Graham John, National President, Trustee Corporations Association of Australia, Level 22, 68 Pitt Street, Sydney, New South Wales

CURRAN, Mr Charles Paul, AO, Deputy Chairman, Perpetual Trustees Australia Ltd, 39 Hunter Street, Sydney, New South Wales 2000

KEAVNEY, Mr Robert John, Managing Director, Investor Security Group Pty Ltd, PO Box N7072, Grosvenor Place, New South Wales 1220

MAPLE-BROWN, Mr Robert Lee, Managing Director, Maple-Brown Abbott Ltd, Level 28, 60 Margaret Street, Sydney, New South Wales

O'NEILL, Mr Paul Timothy, General Counsel, Asia Pacific, The Bank of Bermuda Ltd, Hong Kong Branch, 39/F Edinburgh Tower, 15 Queen's Road, Central Hong Kong

CHAIR—Welcome. Do you have any comments to make on the capacity in which you appear?

Mr Curran—I appear as a member of the public and I also have a role as deputy chairman of Perpetual Trustees.

Mr O'Neill—I spent 11 years with the Bank of Bermuda in Bermuda, four of them as managing director, and am currently the senior compliance person for the bank in the Asia-Pacific region.

CHAIR—We are already running significantly behind schedule. I do not intend to allow us to get much further behind schedule, if at all possible, so I would ask that we do keep this session to the half an hour that was scheduled. Between you, would you keep your combined remarks to no more than 15 minutes, to allow at least 15 minutes for questions. I do not know how you want to break that up between you, but I will hand over to Mr Curran to open up.

Mr Curran—Thank you for the opportunity of making this submission. I have lodged a submission with the committee. I ask that that be read into the record, if that is the appropriate procedure.

CHAIR—No, that does not need to be read into the record. It is taken as being part of our records.

Mr Curran—Thank you very much. In regard to that submission I wish to make it clear that I did hold the role as vice-chairman of Perpetual Trustees. I have been advised that I should give more background to this hearing, and that I will do briefly.

I have been a director of a number of large public companies, including chairman of the Greater Union Organisation, chairman of the Medical Benefits Fund, chairman of the Australian Wool Exchange and chairman of Capital Television. I am currently a director of QBE Insurance group and Davids. I have had a number of government appointments including chairman of the New South Wales Commission of Audit, special adviser to the Premier of New South Wales on the Australian Securities Commission, chairman of the committee of inquiry into the Sydney County Council, chairman of the committee of inquiry into the Prospect County Council and chairman of the independent commission to review Tasmania's public sector finances, as well as a number of other public duties that are not pertinent to this inquiry.

In my submission, I suggested that significant structural change to an important element of national, economic or social life would normally be considered in the event of serious shortcomings in the existing order. This is not the case with regard to managed investments in Australia. On the contrary, it could be said that the sector has grown well and has shown sound and vigorous growth.

This has resulted from the respective contributions of the industry participants, including wholesale and retail fund managers, parties who have used collective investments to fund their business and investment enterprises, the trustee company industry and the legal, accounting and actuarial professions. One can identify more than $150 billion which has been marshalled by collective investment vehicles. These funds have been invested in a wide range of underlying assets, including shopping centres, general and specific property trusts, equity and debt investment funds and many other innovative investment opportunities.

In view of the time limits, I would like to draw several principal points from my paper. The existing system is not unduly complex or costly. Having been developed within a commercial and professional environment, it has been demonstrated as providing sound investor protection. The threat of failure of an investment manager is very real, as witnessed by the collapse of Barings, which had been a highly regarded international investment bank. However, the holders of more than $80 billion of securities managed by Barings were protected as the underlying investments had been held by an independent trustee.

There were also difficulties encountered in London in 1996 by Morgan Grenfell Asset Management. More recently, we have witnessed the collapse of Peregrine in Asia and a number of Japanese investment firms, which illustrates the need for continuing external investor protection.

The greatest vulnerability facing investment markets at this time lies within the field of derivatives. This factor alone should be a reason for ensuring that investments made on behalf of investors are protected from possible adverse consequences arising from the

derivatives trading activities of investment managers, their parents and associated entities. This protection is available through independent trustees and custodians. I would also add that in recent years we have read of major international banks, including New York based banks, having been involved in totally inappropriate derivatives trading operations.

In terms of Asia, there was an article in yesterday's *Financial Review* referring to Yamaichi Securities with off balance sheet losses of $2 billion undisclosed between 1991 and 1997 and Daiwa Bank where a bond trader lost $1.1 billion between 1985 and 1995. We are not talking about theoretical situations here.

My next point is that the existing system, operating as it does in a commercial environment with competitive offerings by a number of fund managers, trustee companies and custodians, has allowed the introduction of dynamic and innovative investment arrangements into the Australian financial market to a level of $150 billion. This includes the rural sector which I heard with interest referred to earlier.

The existing system, as pointed out in my paper, includes insurance arrangements. For those who might not have had direct experience it might appear that one would just go to an insurance company or an insurance broker and take out a policy. It is very different from that in reality. We have very close involvement with our insurers in London. They take the most detailed interest in the compliance arrangements and the risk management arrangements that we have in place in our business and that we enforce in the organisations with which we deal. Not surprisingly that is the case because the insurance companies are on the line as well as us.

The proposal contained in the bill involves the elimination of a proven existing system and its replacement by a monopoly role to be undertaken by the ASC, which inevitably will operate in a bureaucratic and complex manner. I do not say that with any intent to disparage the ASC—far from it. But, when promoters or managers come to us, we make a decision as to whether we will act as trustee for their arrangement. We do so in a competitive marketplace. We do so with the intent of insuring that any arrangement with which we are associated will not involve investor loss. That would be bad in principle, but also very bad for our name. We are not in a monopoly situation. We can choose to reject applications by inappropriate applicants in the knowledge that those applicants can go and knock on the doors of other trustee companies and endeavour to have their arrangements handled there.

It would be a very different situation with the ASC. I know there will be policies developed by the ASC. If it has been satisfied that the guidelines have been met, even though there might be misgivings on their part as to the experience and background of the promoters, the ASC will find it very hard as a monopoly controller to reject those applications.

The Australian proposal has not been adopted in any other major investment market in the world. This in itself should provide some indication of the worth of the proposal. Furthermore, in an era of increasing globalisation it is inevitable that the attractiveness of

Australian investment opportunities to international investors will be diminished if the only collective investment vehicles available incorporate alien and unproven features.

I read with interest the report of the Prime Minister's address in Brisbane on 14 March where he spoke of the aspiration of the government to have Australia as a major financial centre. By the way, I think we all, including the previous government, aspire to that goal. He spoke about having a coherent legal system readily understood. There is no doubt that this particular aspect, if introduced into the system, would not be readily understood by the international financial markets.

There is another reason as to why the existing systems should be retained at least as an option. Under the proposed new arrangements, without the benefit of the participation of independent trustees and custodians it is likely that many investors would favour the larger fund managers as apparently offering greater security. This will make it difficult for emerging fund managers to establish alternative offerings.

It is suggested strongly in my submission that such an outcome is undesirable as unduly stifling opportunities for innovation within a market driven investment sector. It is this feature which might well explain why the proposal incorporated in the bill has been so strongly advocated by a number of larger fund managers. It also explains why a number of smaller fund managers are expressing their opposition to the proposal. That includes a number of the smaller rural promoters and we all know it is terribly important for us to get additional investment in rural Australia.

The final point I would make is that, by proposing that the Australian Securities Commission undertake the role envisaged, the government of the day must accept financial and political responsibility for investors who suffer as a result of the inevitable difficulties that will arise from time to time. The government would be relieved of this latter consequence if it were to allow a dual system to operate. Under those circumstances, in the event of default by an investment scheme supervised by the ASC, the government could point to the fact that investors had alternative investment opportunities available through investment vehicles administered in the traditional manner, involving trustees and custodians. It would be possible for the government to say that investors, having chosen what must inherently be a more risky investment vehicle—namely, one relying solely on a single responsible entity and government supervision—should accept the consequences of default.

I conclude by saying that I find it difficult to understand why parliament would consider introducing the arrangements contemplated in this bill. The only objective served would appear to be the passing of greater power to the government bureaucracy, and the protection of the strong market positions currently enjoyed by a number of major fund managers. For the reasons set out in my submission, whilst I am opposed to the concept incorporated in the bill, I do say that if the parliament does choose to allow investment arrangements involving a single responsible entity it should allow this, but not to the exclusion of the existing arrangements.

If the new arrangements are to be allowed, let the market determine which arrangements investors choose. Such an approach fully accords with the principles of investor choice. It would preserve the existing arrangement for use by the Australian financial market in the event of the single responsible entity approach being trialled and found wanting.

CHAIR—Thank you, Mr Curran. Mr Maple-Brown is next.

Mr Maple-Brown—Thank you for the opportunity to address the members of the committee. I will be as brief as possible. Prior to starting my own firm, I was investment director for Rothschild Australia. I have been in this industry for 28 years and have operated in only two firms. I am therefore familiar with the investment management industry. My own company is 100 per cent owned by Australians. It employs 20 people. We manage $9 billion and we have an enviable record in managing Australian equity portfolios and superannuation funds.

It is our understanding that the Managed Investments Bill was intended to provide increased investor protection. However, we strongly believe that the omission of the need for an independent custodian has significantly increased the risk to investors, both large and small. We are concerned that fraud could be committed by a fund manager; and an independent custodian does provide significant protection against this crime. We have seen no evidence of substantially lower costs and, even if we had, they are unlikely to be significant in relation to the potential losses that could be inflicted upon a small number of unfortunate investors. We respectfully ask the committee to recommend that the bill be amended to include an independent custodian, without any exceptions.

CHAIR—Thank you, Mr Maple-Brown. Mr O'Neill is next.

Mr O'Neill—Mr Chairman, I have prepared some notes for this submission. In the interests of brevity, may I ask for them to be incorporated in the record? I will simply highlight a couple of points.

CHAIR—As there is no objection, it is ordered that the document be published in a separate volume.

Mr O'Neill—Thank you. By way of very brief introduction, the Bank of Bermuda is a major institutional trustee in a number of jurisdictions around the world. In Asia, we are the largest institutional trustee in both Hong Kong—where we have around 50 per cent of the market share—and Singapore, where we have approximately 75 per cent. I personally have been involved in working in this business for the Bank of Bermuda for 11 years in Hong Kong.

For 1½ years, since I ceased being managing director of the Hong Kong office, which has approximately 480 people, I have served on various committees in Hong Kong, including on the Securities and Futures Commission's committee on unit trusts and mutual funds, and on a committee on retirement protection, which was the prelude to the mandatory provident

fund legislation that you may have read about. The direction of that committee was very much considering issues about protection of members' retirement savings. I appreciate that that is a slightly different focus, but it was very much an area that we spent a lot of time considering in that committee.

My sole purpose is to provide an international dimension and to explain very briefly the position, particularly in Hong Kong and Singapore. The current position, simply, in both of those places is that the role of an independent trustee is well established and there is no proposal that that should be changed. In fact, the direction is very much along the lines of looking to supervise more strenuously the position of the trustee. In simple terms, it is much easier to supervise the trustee than it is for the regulator to get involved in looking at the underlying investment funds. This is very definitely the way to do it.

I have explained in the notes—and they are very much by way of notes—some further background to the provisions in Singapore and Hong Kong. The new mandatory provident fund legislation in Hong Kong, for example, requires that the underlying investment vehicles be unit trusts that are actually formed and administered in Hong Kong—again, so that the protections that do apply to unit trusts currently also apply to the underlying investments that come through the mandatory provident fund regime. The amendment to the code in Hong Kong, made in December 1997, required specifically that the trustee would be subject to regulatory supervision or to have an independent audit of 'internal controls and systems on terms agreed with the Securities and Futures Commission'.

The same position currently applies in Singapore. There are no proposals in either of those jurisdictions to change or water down the role of the independent trustee. In some other places, there is in fact a requirement within the trustee that certain functions are actually split so that they are performed independently from the custodial and fiduciary functions—for example, undertaking valuation or unit holder record keeping. In Hong Kong and other places, such as Jersey, there is a requirement for an annual statement from the trustee to be included in the accounts for that particular fund, whereby the trustee has to state positively whether the fund manager complied with the terms of the constituent documents of the fund or otherwise.

The reasons that I believe very strongly that the independent role of the trustee should be maintained are, first of all, the real or perceived conflicts of interest. There are many judgments required in terms of what expenditure is permitted. No matter what policy guidelines you have, there is still a judgment required at the end of the day as to whether something is appropriate or not. With many of these things, the fact that you have to go through the process of having another set of eyes looking at it does apply discipline to the fund manager. Such situations as valuation errors can be very damaging to a fund manger, both financially and from a reputation point of view. The fact that the trustee is in there provides an important control.

The prevention of fraud is something that obviously is not assured with the trustee; but certainly I can say, from the basis of practical experience, that the separation where there is at least a requirement for transactions to be reported on a current basis to a trustee for

settlement does provide a measure of protection that is not there otherwise. As was referred to earlier, if you have a situation with small fund managers, you may say that best practice requires centralised dealing or other controls; but, in a small fund management office, whatever you say in a policy just does not happen. You cannot have different people performing different functions, unless you find that you have to have an office of 15 or 20 people before you can manage one fund—and, then, how experienced are they?

Another point from my experience in Hong Kong is that the compliance culture is not always easy to instil in a fund manager. The people who are running fund management operations are there because they are good fund managers or they are good marketers of money. They are not there because they are good at running the back office. I have seen situations where the back office has not been up to scratch. Particularly in times of economic constraint, this is an area in which they will not be investing, in some instances.

The second reason I believe it is very important to have an independent trustee is in dealing with crisis situations. From what I have read—and I have been away for more than 11 years—we have been very lucky in Australia that there have not been any major shocks here. I have been in Hong Kong where we have gone through October 1987, when the stock exchange was closed for three days; I have been through 4 June 1989; I have been through the Barings collapse; and I have been through, in part, the Asian crises—including the fact that the Bank of Bermuda is trustee for the Peregrine funds in Hong Kong. We were involved as administrator, or custodian, for a number of Barings funds, as well. I have got some practical experience in dealing with these issues.

If you have a situation where, over the weekend, you suddenly find that a holding company—as in the case of Pyramid—is in a situation of provisional liquidation, the ramifications for companies in the chain of that corporate entity that are managing underlying funds are extremely complicated to deal with. You have a situation where, at the end of the first week, you have no-one actually managing the money, because they either have been poached or are not getting paid, and so they are not there to actually do it. A number of weeks later, you find that the actual fund management company is either in provisional liquidation or in liquidation.

How do you deal with that situation? You have to deal with it, firstly, by having the experience of knowing and, secondly, by having flexibility such as I do not believe any regulator can really apply without having the situation where a trustee has actually got control of the assets away from the fund manager, so that you do not then have all the complications of having custodianship and trusteeship tied up with companies in the fund management group.

The final point I make is simply in terms of specialisation. As this industry develops in Australia—from my perspective from Asia—I believe that the complexity and range of funds will only increase. In Hong Kong we have seen a lot of hedge funds and similar. They are extremely complicated. The documentation requires expertise in how it is dealt with, and the perspective of the fiduciary dealing with these things to protect the interests of the fund is extremely important. I would be very concerned if you had to go through the responsible

entity and rely on their expertise, bearing in mind that you have a wide range of sizes and skills, simply to try to attack an underlying custodian in the event of there being some failure.

In conclusion, looking at the proposal here, in my own mind it is analogous to looking at the current values that have been in the corporate scene in Australia in the 1980s and suggesting that, because external auditors failed in their task—and there has been a dispute as to whether it was the auditors or the directors—you should get rid of the external auditors, make the directors responsible entirely for the affairs of the company and let them appoint internal auditors to perform the same functions. Technically, you could in theory achieve the same standards, but I do not think any of us would believe that the lack of independence would not remove a great deal of investor security.

CHAIR—Thank you, Mr O'Neill. Mr Keavney is next.

Mr Keavney—Mr Chairman, being mindful of the time, I will table a paper and speak in summary form. I am not a fund manager and I am not a trustee. I am an investment adviser. My clients are the human beings that all of this legislation is about. We do not manage large pools of any personal money. I sit down across the table, I know the clients' names and their ages, I know how much they spend on their groceries, and I have to explain to them what went wrong when money is lost.

We have $420 million of our clients' funds, which I have handed to other people, fund managers, to manage. My interest in this bill is my fundamental responsibility to make sure that no change to the legislation puts such money in other people's hands at risk, because I have to sit down and look the clients in the eye and talk about what I did wrong that led to risking their assets.

Briefly, my background is that I have been in the industry since 1982. I have run my business since 1984. I have been named Australia's Financial Planner of the Year on two occasions, and I have had a number of responsible roles in the industry association, including being past chairman of the national advisory committee to the board on electronic commerce.

The people who are arguing for removal of trustees from managed funds are telling you that the current law is not working. I read the 87 pages in *Hansard* from the first hearing and found two examples mentioned of managed funds where there was fraud and misappropriation: Estate Mortgage and Aust-Wide. The reason you will find that these same names, but no others, come up over and over again is that there are very few examples of fraud and misappropriation in the managed funds industry.

The industry has an extraordinarily good track record in avoiding theft. Yet managers are claiming that the current system is risky. I want to tell you that managers tell me something different from what they are telling you. If any manager starts to tell me that my clients' funds are at risk in managed funds, I am taking the money out of there. The fund managers

are not telling me that and are not hinting in any way that the money I have given them is at risk of theft.

If managers believe that independent directors and compliance committees will add to the security of my clients' funds, I want them to do it now. You do not need to wait for a change of legislation; you do not need to disband trustees; there is nothing to stop you from having the best of both worlds. Why are these steps not being taken now, if they are necessary for security?

In my view, the reason that these changes have not been made up to this time is that the fund managers of Australia do not actually believe that there are significant risks for money to be stolen out of their funds. So, whatever the motivation is for proposing changes to this legislation, in my view it is not that the fund managers of Australia actually believe that there is significant risk—or, in fact, any significant history—of misappropriation under the current system.

There is talk about the confusion of responsibilities: who is responsible if money is stolen? There has been a quite ludicrous argument, in my view, as to who has the deeper pockets. Speaking on behalf of my clients, two deep pockets are more than one; we will sue anybody. There might be a confusion of responsibility, but I do not care. If there are two people to sue, and one is richer than the other and one is poorer than the other, it is of no interest to me: there are two people whom we can have a shot at, and my clients would take both parties' invitation to sue them as meaning that they have the deeper pockets. Anybody who says that one pocket is more than two is having their self-interest interfere with their capacity for extremely simple arithmetic.

With the talk about Estate Mortgage, there has been a really fundamental point missed. Who stole the money in Estate Mortgage? The fund managers stole the money, and the trustee did not stop it. In my opinion, the trustee was incompetent and went bankrupt and deserved it. Essentially, we have had an argument that says that, under the current system, a fund manager stole money and that therefore fund managers should be given total responsibility for all clients' funds.

I cannot understand the sequence of logic that begins with saying that the problem is that some fund managers steal money but ends with giving total control of all assets funds to fund managers. It would be rather like saying that Scotland Yard failed to stop Ronald Biggs from carrying out the Great Train Robbery. My response to that is that we should give more resources to Scotland Yard. Only the Biggs family would argue that Ronald Biggs should be put in complete control of the trains.

Although there have been a small number of instances of fraud under the current system—which I view as evidence that the system is working—in each case the problem has been that a fund manager stole money. I do not want to conclude from that that we should remove external supervision on them. In the last hearing, a principle emerged that it is only

going to be four per cent of any group of people who are likely to behave wrongly, and I accept that principle.

Whether it is two per cent or six per cent, I do not know; but, in my view, for the 96 per cent who are not going to steal money, you can put any legislative regime on them that you like, and they will comply. What I am interested in is that I want the legislation not to forget about the existence of the other four per cent. The question is this. We are now talking about the four per cent or the one per cent who are willing to be crooks: should those people be given the only key to the safe, or do you want to stand a guard by the door?

You will come up with a different view on this legislation, if you think about what is good for the mainstream, who are ethical. The people who will speak to you today will never steal clients' funds. But you will come up with a different view if you think about what it is necessary to protect in the situation of the sleaze-bags. Estate Mortgage showed that there can be sleaze-bags in our industry. It would be extraordinarily naive for us to believe that this industry alone, out of all others, would never have an unethical operator.

Let me conclude by touching on the question of investor choice. Let me put my cards on the table. I do not want independent trustees removed at all. But, if the government is persuaded that there needs to be change, that change should be by saying that the investors are entitled to determine if they buy the story that they are better off in funds without trustees or they prefer to remain in the vehicle that they chose to go into. This would work by each fund having a unit holders meeting and allowing a vote where unit holders decided on their own fate.

The fund managers of Australia seem to be opposed to allowing investors to determine their own fate in this. I can only conclude that it is because they do not believe that the majority would vote for the elimination of trustees. If we are not convinced that the people whose money it is want this change but we, the industry, want it, then I suggest we have forgotten whose money it is that we are managing here.

We are in a situation now—which, I have to say, is ludicrous—where we have some fund managers, such as Robert Maple-Brown and Fidelity and others, who have said that in their funds they do not want the trustee removed: in those same funds the trustee is saying, 'I don't want to be removed,' and we have not heard from the investors that they want them to be removed; yet we are considering legislation that without choice—even though no party is in favour, in that situation—trustees should be removed. If there needs to be a change, you have to allow the investors in each fund to make a decision as to whether they think it is more economical for them, and whether they think they get greater security.

One selfish note—because at this stage I have spoken nothing about what I think is in my clients' best interests—I consider the investment advisers of Australia to be at the leading edge in terms of quality of care and concern for our clients. I do not believe that my organisation, or any other financial planning organisation in Australia, has any skill in assessing the risk of fraud under the new sorts of arrangements that are proposed. It would

be very difficult for us to acquire the skills to assess the real independence of the alleged independent directors and to assess whether compliance plans would be adhered to or not. My industry, which actually delivers the money, will go through a significant learning curve. This is not a set of skills that we have had to have until now because we have relied on trustees to play that role.

Let me finish with a prediction. If independent trustees go, some time in the next two, four, six or eight years one of the four per cent will steal money. We will have a public scandal. Newspapers will write articles that will say, 'You are better to invest directly than to run the extra risk of putting your funds in a fund manager's hands.' All the managed industry in Australia will suffer, good and bad, as will we as investment advisers.

Why are the fund managers so focused on reducing the fundamental security of their product? It is because we have been in good times. The end of the 1990s is like the end of the 1980s. Everybody has made money; there has been no fraud; the market has been healthy; and everybody has lost their caution. You lose your caution first; you lose your money second.

CHAIR—Could I perhaps open with a question to Mr O'Neill? You described to us the regulatory arrangements that are in place in several of the jurisdictions in which you operate. Could I ask you perhaps to provide a comparison between what is proposed in this legislation and the regulatory arrangements that apply in some of the other jurisdictions into which you transfer funds for tax minimisation purposes, such as the Cook Islands, Samoa, Mauritius and some of those other more exotic places?

Mr O'Neill—None of those jurisdictions is actually used. They are basically there for private trust business. I can certainly talk about Bermuda, the Cayman Islands, Luxembourg, Dublin, Jersey or Guernsey where we do have substantial institutional trustee businesses. None of those has any legislation that removes the requirement for an independent trustee. They all in fact require an independent trustee or custodian.

CHAIR—Mr Curran, are you the director of a single responsible entity under the SIS regime?

Mr Curran—No, I am not.

CHAIR—You do not have any involvement?

Mr Curran—I certainly have interest in terms of the supervision through Perpetual Trustees.

Mr Bradley—One or two of our public offer funds have Perpetual Trustees Australia.

Mr Curran—Yes.

CHAIR—Do you use an external custodian to hold those scheme assets?

Mr Curran—Yes, we do.

CHAIR—You do not operate under a single supervisor?

Mr Curran—No. In a number of the funds that are operated by Perpetual we have selected external trustees to hold scheme assets.

CHAIR—Under SIS?

Mr Curran—There may be one or two under SIS where we do have internal, but there are a large number where we have selected external.

CHAIR—For those where you do have internal arrangements, that is consistent with what would apply under this legislation, is it not?

Mr Curran—No, I think it is very different. We are a trustee company which is very much regulated by the state jurisdictions with particular responsibilities, and really quite different from a mere fund manager that might choose to be a single responsible entity.

CHAIR—Mr Keavney, would you say you were here representing investors, in effect?

Mr Keavney—Yes, I would.

CHAIR—Why does your position appear to differ from another group that represents investors, namely, the Australian Shareholders Association?

Mr Keavney—I cannot answer that. I do not know the view of the Australian Shareholders Association.

CHAIR—They are supporting the legislation.

Mr Keavney—Not being familiar with their view, I cannot answer it in detail. The best way to answer it might be to answer the question I thought you were going to ask me, which is that I have actually got a different view from the Financial Planning Association of which I am a member.

CHAIR—Hang on, we are the politicians, we answer the questions that we want to answer!

Mr Keavney—I thought it would be a good question and I have been preparing for it!

Clearly, in this industry there is a bunch of intelligent people, all of whom want to look after investors, and who form different views. Fundamentally, why I have come down on a different side from a number of other people who are equally genuinely interested in the welfare of investors is that most of them are talking about what they think is going to be the best legislation for the best fund managers. They are the people who manage large amounts of money. No-one questions their ethics. In fact, no-one questions their depth of resources.

I had clients in Aust-Wide. I recommended clients invest in Aust-Wide. It was not the most brilliant thing I ever did and it taught me a wonderful lesson. At the end of the day my job is to not lose clients' money. Therefore, if there is a risk then I want to stop it, but if there is a trade-off between risk and return, that is okay, I am happy to live with that. Others will have formed a different weighting emphasis.

Senator GIBSON—Mr Maple-Brown, my understanding is—and I just asked the ASC before—that you could appoint a trustee company to be independent custodian of your managed funds if you so wished and to market that as an additional thing for your clients. Why is that not attractive to you?

Mr Maple-Brown—We will certainly do that, and we have been doing that in every business that I have ever had. I practice what I preach. What I am concerned about is that the disreputable fund manager will not choose that option, he will choose to be a responsible entity and take the money. That is the situation I am worried about. I am not worried about my own interests, I am worried about the industry.

Mr LEO McLEAY—Mr O'Neill, in your letter to the Treasurer you said that you thought such an approach, that is, the proposal in this legislation, would seem likely to limit the potential scope for Australian investment products to be allowed to be marketed in other countries and, indeed, would considerably diminish the prospects for export to Asia in particular of Australian expertise and systems for the servicing of collective investment schemes. I am not so much interested in the question of expertise but in the question of promoting Australian investment products overseas. Could you expand a bit on your comments there?

Mr O'Neill—I was looking a fair way into the future and looking at the European model where they have usage legislation which stands for the legislation that is in the EC. Essentially, it means that if you have a fund that is formed in one country which is essentially an EC country then that fund, prima facie, is able to be marketed in other EC countries. There are a lot of other specific marketing rules in that country that apply. In practice it has not worked terribly well.

I guess I was looking at that example and saying if I am looking down the track at the Asian situation—and I do not know how many years or decades it might be—if supervision and regulation were capable of being harmonised, clearly it can be much easier at that point of being able to market Singapore funds in Australia and Australian funds being marketed in Hong Kong or Singapore. I was crystal ball gazing to a certain extent. It is a bit like the

gauge of the railway, if we start out now on a completely different track we have very little chance of being able to get there at any time in the future.

Mr LEO McLEAY—Mr Keavney, Mr Maple-Brown said that regardless of the outcome of this legislation, he would still appoint an independent trustee.

Mr Maple-Brown—Yes.

Mr LEO McLEAY—I would have thought that would have been a good business marketing proposition anyway. Mr Keavney, from your point of view in the industry, would that not mean that most people in your position and who are cautious would recommend that sort of investment to a client? If that were so, the government could find that the vehicle they are promoting in this legislation might just never be used, that people might not take the standard model which this legislation is about, they would buy not the deluxe model but the standard-plus model which good marketeers would put forward.

Mr Keavney—I absolutely agree, and I would like to take it one step further. If individual funds were able to make a choice as to whether to dispense with the trustee or not, because a trustee is one step further than just an independent custodian, then the marketplace could choose whether it felt that there was extra security with an independent trustee. Certainly, it would be a factor that we would be looking at in terms of which funds we would recommend. If there is not an independent trustee we would certainly want to see an independent custodian as a fall back position.

Mr LEO McLEAY—My final question is to Mr Maple-Brown. As a person who is a promoter of these sorts of funds, do you think this legislation may be a waste of time?

Mr Maple-Brown—I can certainly understand why some of the larger fund managers can see some benefit in the legislation but it seems very marginal to me. I have read the costings from various people and I have listened to the ASC this evening talking about cost. To date I find it very hard to see any cost savings in the legislation, but I can see considerable weakness.

As a chartered accountant and a former auditor, I believe independence is an extremely important principle. I would like to see at least two independent bodies included in this bill. As this bill was originally framed, it did include an independent custodian. I have become nervous when I have seen this version of the bill with the independent custodian removed because I think it is considerably weaker with that exclusion. I would like to see it reinstated.

Mr ANTHONY—Mr O'Neill, you mentioned the Bank of Bermuda was involved, I assume as trustee, for Baring Brothers and also Peregrine. Is that correct?

Mr O'Neill—In the case of Peregrine, certainly we were trustee, custodian and administrator. In the case of Barings, we were certainly custodian of many of the funds, and I think administrator, through our Guernsey and Luxembourg offices.

Mr ANTHONY—You provided that by way of background. What advantage was that for people who invested with Barings or Peregrine?

Mr O'Neill—The big advantage is that we had been through this experience before. This was a shock but we had the flexibility to be able to deal with the event. A regulator has to apply a much more formalised approach. You do not have time to look at the policy manual to see whether you have anticipated that particular shock. The important thing is, as the trustee, that you are outside the mess.

You have the assets, and your sole obligation is to protect the interests of the unit holders. In many cases, as in the case of Peregrine, these funds were contracting with other Peregrine entities. They were derivatives. If these were all part of the same corporate network and the trustee was part of the same network as the custodian, this would be an enormous problem.

Mr ANTHONY—At the end of the day, if I was an investor in Barings, my return would have been no more or no less whether you were a custodian or not, I assume. They still lost money.

Mr O'Neill—I am sorry, they did not lose any money.

Mr ANTHONY—Barings?

Mr O'Neill—No investors' money was lost at all.

Mr ANTHONY—Was it guaranteed?

Mr O'Neill—There was no guarantee, but it was always protected. The sole issue was the fact that a number of Barings funds had actually placed funds on deposit with banking entities within the Barings group. That was the only exposure that existed. As I say, we were certainly custodian for billions of dollars of assets of these funds. The only issue was really the fact that there were some deposits with Barings banking entities, and those banks all paid up their customer deposits.

Mr Bradley—If I could just add to the question, Mr Anthony: there is a good paper in the submission by Ian Warner, setting out the history of the Barings Bank failure. The situation is as Mr O'Neill said. The shareholders in Barings lost all their money, and people with unsecured deposits in Barings lost all their money. But, for those who were in managed funds, where all the assets were held by independent trustees—in particular, in that case, the

Royal Bank of Scotland's trustees—not a penny was lost, including all the money Her Majesty had invested in those funds.

Mr LEO McLEAY—Was that the same with Peregrine?

Mr O'Neill—Yes. The problem with Peregrine was finding a new investment manager. All the money was held entirely by us, because we were custodian and trustee for all of their funds, so there was never any issue of those funds being involved in the liquidation. The issue that we had was dealing with the liquidator, who was obviously anxious to sell the asset management companies for something. Our position was simply that we were dealing with this; the funds had to be managed; we could appoint a new manager and in many situations we had to deal with the interim situation ourselves. It would have been impossible if we were all caught up as part of the same Peregrine organisation. That was a major group. They were the largest investment bank, under some measures, this time last year. It happened there; I do not think we can pretend that it is impossible that it would happen in Australia.

Senator CONROY—One of the issues Mr Bradley has raised, and which I know some of the committee members have been concerned about, is this question of inter-transactions, again pointing to a Peregrine. How does the independent trustee or the custodian stop what happened in Peregrine?

Mr O'Neill—There was no problem with the transactions; it was simply a case that Peregrine was a multifaceted investment group. There were brokerage transactions. They were quite properly done: there was no breach of investment guidelines or anything of that sort; there were entirely appropriate investments. It just simply happened that, as funds become more complicated and sophisticated, you have derivative instruments, and in some cases they used their own securities company. They used other securities companies as well, but unwinding those was much easier to deal with, in the sense that we were on one side dealing with the liquidator, than it would have been if we were all part of the same mess.

Mr Bradley—I need to table an additional submission this evening. I need just to say a word of introduction to it; I will take but two minutes.

At the outset of these hearings I posed a question for the committee to consider: does this bill in its current form make managed funds a whole lot better and safer for the ordinary investors, clearly and unarguably? We submitted that, if the bill does not, it does not deserve the parliament's support.

I submit to you that the answers to this question that the committee has received from supporters of the bill have been equivocal—'We believe it will, it should, but no-one can be sure.' There are a series of quotations from both the submissions and also the hearing which I would like to draw to the attention of the committee. In addition, there are a number of misleading statements in relation to this matter which have been made during the hearings

and the submissions. I would like to table a further submission on behalf of our association which attempts to correct the record in relation to those statements.

This submission also answers some questions that were posed to me by Mrs Johnston and by Senator Conroy at the last hearing. It contains a chart, among other documents, that highlights which countries in the world have a system that requires a manager and a trustee; those that require a manager and a custodian; and those that require only a single responsible entity. I table this document and ask that it be incorporated in the record.

CHAIR—The document is received.

Mr Bradley—Thank you, Mr Chairman. I have one further comment. We believe that this committee has before it quite a few options in relation to how it approaches this bill. We have set out in a further submission, which was tabled with the committee earlier in the day, the five or six options that we believe the committee should be considering in relation to this bill.

Having had the benefit of the submissions and attending the hearing, we believe that there is a large range of options and, in addition to that, a larger range of substantive amendments which make it clear, we submit, that this committee does not have the option of recommending this bill without amendment. In our view, the clearest and easiest of these options is one that is not before the committee at the moment. It is contained in our supplemental submission which we lodged today, entitled 'Models for consideration'.

The clearest and easiest option for this committee—

CHAIR—Mr Bradley, could I interrupt. I do not intend to let you go through all of your proposed amendments. If they have been tabled we will consider them, but you have had now some 50 minutes in addition to your own time in camera. It is getting very late. We really need to draw your evidence to a close here unless you can finish in 30 seconds.

Mr Bradley—I can do that. The document outlines two options that this committee should consider. The first is simply clarifying and amending the current law to eliminate the perceived confusion. There is a New Zealand draft bill to that effect. It is two pages long and not 100 pages of legislation. It is set out in the submission.

The second is a model that has not even been put on the table until this time. It has been developed as a result of taking into account the many submissions for amendments that have been put before this committee. It is one that we believe could accommodate within a single responsible entity framework, but one that enhances rather than diminishes investor protection, a large number of the submissions that have been put before the committee. I would ask the committee to review that document in coming to its decision on this matter. Thank you.

CHAIR—We will do so, Mr Bradley. Thank you very much for that presentation. Thank you to each of you for appearing before the committee and also answering our questions.

[10.11 p.m.]

BREAKSPEAR, Mr Kenneth Charles, General Manager, Policy and Research, Financial Planning Association of Australia Ltd, Suite 1201, 403 George Street, Sydney, New South Wales 2000

CHAIR—Welcome. Do you wish to make an opening statement?

Mr Breakspear—Yes.

CHAIR—Please proceed.

Mr Breakspear—Firstly, thank you for the opportunity of speaking briefly tonight. We did make a two-page submission to the committee, dated 11 March. That would be on the public record and I will not go over that, other than to flesh out a couple of key points.

The Financial Planning Association is the professional body for financial planners and advisers within Australia. We have currently about 385 licensed advisory organisations, ranging from the very large banks to the very small boutiques. Those licensed investment advisory organisations employ or have contracted with them some 9,000 advisers.

The advisers that work within the FPA's code of ethics and rules of professional conduct carry out very important functions in the financial system. We understand, based on the statistical information and surveys, that approximately 80 per cent of funds in managed funds come through advisers. That is, people do not enter the transaction on a stand-alone basis but, in fact, do rely upon advice.

In our submission we highlight the fact that advisers have statutory responsibilities. Under section 851 of the Corporations Law they have a responsibility to investigate the soundness of the particular fund managers and the appropriateness of the particular products at hand. This translates down when we come to looking at this question of managed funds and the quality of fund managers, and the trustee system or the replacement to that is one of the key factors that advisers may take into account when assessing the quality of a fund manager and an individual product.

The legislation requires that investment advisers investigate the soundness of fund managers. They do so by a combination of external investment research companies that undertake qualitative and quantitative research. Quite a number of the larger advisory groups have their own in-house researchers who also carry out the investigation. What is important is that the advisers, in undertaking this task, have determined that the specific value of a trustee is something less than perhaps they held some years ago.

In preparing our submission we took advice from our members. We have a committee structure by which we go through a process of consultation and, apart from Mr Keavney's, we have received no negative responses about the legislation that is proposed.

In my discussions with particular advisory organisations, they have said that they concentrate on the fund manager and on the quality and substance of that fund manager and that the appointment of a trustee, in their view, does not add a lot of value to the equation. In fact, they have indicated to me that their reliance is really upon the fund manager. I would guess that the great majority of our members would deal with the mainstream fund managers and not necessarily with those at the margin.

In terms of the bill, we did suggest in our earlier submission that there would be some value in having an independent custodian. We noted that the final bill did not have that in it. We considered this and decided, as an association, that it would be preferred to let the market choose whether a fund manager did appoint an independent custodian or not. We have seen tonight that some fund managers will choose to do that, because of efficiency or because of their competitive position. Investment advisers will take into account in rating a fund manager whether they have appointed an independent custodian. They will make some value judgment about the value of that.

Also, in relation to the existence of the external directors and the early warning system that there may be there and the duty to report any breaches, we believe it is important that those who are engaged in this independent scrutiny and review in the compliance committee or on the board have qualified privilege in relation to those reporting functions. It is very important that, where they suspect a breach, they feel confident enough to approach the regulator about that. That is probably all I would like to speak about. I am happy to take any questions.

CHAIR—Thank you, Mr Breakspear.

Mr LEO McLEAY—You said that your industry would tend to deal with the more established funds. Would the provision of an independent trustee enhance the marketability of smaller funds or newer funds?

Mr Breakspear—That is probably a question of perception. By perception, yes, probably it would. For a new player in the industry, a smaller player, an independent custodian may well bring some value to the exercise.

Mr LEO McLEAY—If you were a person who was making recommendations, would that influence you?

Mr Breakspear—I do not actually make recommendations—I am not an investment adviser—so it is difficult for me to put myself in that position.

Mr LEO McLEAY—Were you ever an investment adviser?

Mr Breakspear—No; my background is in chartered accounting, in regulation and in industry association.

CHAIR—Thank you very much, Mr Breakspear, for your appearance before the committee.

[10.19 p.m.]

BUN, Ms Mara, Manager, Policy and Public Affairs, Australian Consumers Association, 57 Carrington Road, Marrickville, New South Wales 2204

KELL, Mr Peter Richard, Senior Policy Officer, Australian Consumers Association, 57 Carrington Road, Marrickville, New South Wales 2204

CHAIR—Welcome. Do you wish to make a brief statement?

Ms Bun—Thank you very much. I would like to start with some very general comments and Peter will perhaps bring those more to life. Firstly, for those of you who are not familiar with the Consumers Association, we are a not for profit organisation. We have over 200,000 subscribers and members. Our funding comes entirely from that group of subscribers and members. We essentially have no relationship commercially to this issue. Our objective is to advocate on behalf of consumers for their benefit.

To begin by broadly stating our views, the Australian Consumers Association is supportive of the proposals. The single responsible entity, in particular, we think is important. There is greater room for accountability in terms of management in this area. Consumers, we believe, will be better served if they are able to deal with a single entity, as opposed to a range of others. We do not think the current arrangements have a clean bill of health, or else possibly we would not be here. Your attention has been drawn to some of the prior problems. They do occur, of course, when markets turn downward and we look forward to improvements before that occurs.

On the question of costs, although we clearly are not experts in this area we note from the Wallis report that there is great scope for improved efficiencies and expense performance in this area. We also note that clearly there is fee income. To the extent that any costs that are saved are not passed on to consumers we are hopeful that competition can help to deliver that. We certainly plan to play a very vigorous role in 1998 and 1999 on managing expense ratios and underlying costs.

We think it is important that consumers, for accountability purposes, know where to go when something goes wrong. The current arrangements do cause confusion and blame shifting, which in problematic times is not a good thing. Although we would remind the committee that legitimate concerns are quite throughout this issue, this is not about protection of funds; this is about protection of investors. In that context, we do think the single responsible entity is the right direction.

Clearly, assets have to be identified in a way that is entirely transparent, and held separately from assets that belong to responsible entities to prevent intermingling and so forth. We think that does not necessarily mean there needs to be a mandated custodian role,

but we think it is absolutely vital that the Australian Securities Commission, in its new capacity, has the ability to make provision for custodian arrangements through discretionary powers.

We think the single responsible entity approach needs to be implemented in the context of a range of elements. I will just briefly go through the essential ones. The first is adequate resources for the Australian Securities Commission. We are concerned that that be absolutely clear. It has licensing as well as monitoring roles to carry out and, of course, the willingness of this new regulator to conduct these duties is equally important.

We think a rigorous compliance plan is fundamental and we would like to draw to the committee's attention a basic distinction between quality assurance and quality control. Quality control is about end point inspection. It is not necessarily the direction that modern business, including the Australian Consumers Association, is moving in. Quality assurance is about responsibility and accountability for clear quality right throughout the chain. Obviously, independence on compliance boards and committees is pretty important, as well as financial reporting of their meetings. Having said that, I will pass it over to Peter.

Mr Kell—Thank you. I will be quite brief. I would like to start with perhaps a few slightly lighter comments. I am frankly quite amazed by the auspicious line-up of eminent and, might I add, well paid personalities that have become involved in this issue. You are indeed a privileged committee to hear these arguments and I am sure they only get better with the retelling. I am not entirely flippant there, because I think to some extent we have lost sight of the bigger picture in which this issue sits.

I, as someone who works solely in the financial services area, would like to see just a fraction of the passion and energy that the industry have devoted to this issue being devoted to some of the other important issues—consumer protection issues and the financial services area. Perhaps they do not pay quite as well in some of those areas. But disclosure, superannuation, ASC and ACCC roles are the sorts of things where this sort of line-up will be very rarely sighted indeed. Frankly, I am quite disappointed that it has taken an industry turf war to bring out such efforts on the part of industry and such concern over consumers. I am sorry if that is a bit forward, but I am afraid to say I have not seen such an assiduous lobbying effort on any other of the key consumer protection issues in the financial services area. I wish they would occur in some of those other areas.

Having said that, this is an important issue. We do think that the buck should stop at one place. We do think that the single responsible entity is important in delivering that. On the other hand, the fact that there is discretionary ability for the ASC to ask for a custodian in particular circumstances is important and the fact that a fund can, if they want, choose to use a custodian is clearly something that allows flexibility under the new arrangements.

As to whether the ASC will be seen by investors as a replacement for custodian in some sort of mistaken sense, my argument would be that most investors would not know a trustee if they tripped over one at the moment. Most investors really do not understand how things

work in this area. Arguing over things like whether they can choose under a dual system or not assumes a level of knowledge that simply is not there. We need a regulatory structure that is going to deliver clear accountability and clear protection, a regulator that is prepared to do its work in a vigorous manner rather than assuming a level of investor knowledge that simply is not in existence at the moment. I will leave it there for the moment and we are happy to take questions.

Senator CONROY—One of the arguments we have heard this evening, which I think you were both here for, was that two pockets are better than one to sue.

Mr Kell—I am after the 10-pocket model. After hearing that argument, the logical outcome is: let us have three or four or five or six pockets. More seriously, the key thing is having someone who is clearly responsible and is not going to undertake a bit of blame shifting when things arise and having money held separately and clearly in a sense that will prevent the intermingling and misuse of assets.

Ms Bun—There is a cost to the investor of having to pick who to sue. That comes in time and angst and money, as we have seen.

Senator CONROY—We had a passionate position from Mr Keavney about investor choice. I know your organisation has always traditionally supported the choice issues. I was just wondering if you wanted to respond to Mr Keavney pointing out that no-one was choosing in a number of cases—and this was a position we were mandating—to take away a choice.

Mr Kell—I am not quite sure I completely follow that point. As I said at the beginning, I think most mum and dad investors in this area do not have a very detailed knowledge of what is on offer in terms of the respective roles of trustees and fund managers and who is responsible for what. That is not what we are looking at improving in this situation, although some education clearly can play a role. We are looking at ensuring that the money is held safely; that the regulatory regime offers protection; that we have a vigilant regulator in this area; that the industry has incentives to behave properly; and that there is a strong liability regime.

Ms Bun—That is the critical factor. If the argument is that fund managers lack competence and, therefore, they need baby-sitting, then the argument is: make them truly accountable and make it very clear that that is the responsible entity. At the end of the day, Senator Conroy, the alternative to market a fund that has a trustee and added security benefits is there.

Mr Kell—Scare the dickens out of their directors or something like that.

Senator CONROY—I am afraid I have run out of questions.

Mr ANTHONY—Maybe you can elaborate on how you mentioned before that, if consumers and particularly retail investors are making an investment choice, there seems to be very low priority. I assume it is really the fund manager that they are choosing rather than who is going to be the trustee. Is that correct?

Mr Kell—That is pretty much what it comes down to in our experience. Let me go back one step and say that subscribers and consumers who deal with the Australian Consumers Association are very interested in financial issues. They are very interested in investment issues. They want to know where to put their money. They want to know where to go for advice, but they do not express that in terms of which fund has the best trustee arrangement or something like that. They are looking at fees and charges. If we had a bit of energy and passion devoted to disclosure of those issues, we would be in a better position. They are looking at performance issues. They are looking at the nature of the risk of the investment—whether it is shares, cash management, and those sorts of issues.

Ms Bun—Isn't the key question: how are these products marketed? If it is on the basis of performance, then is it performance on the basis of investment plans and returns and so forth? The accountability perhaps and security at the trustee side has not been marketed today. If you ask people, what would they say?

Mr ANTHONY—You are saying that it is a very low ranking as far as investment choice.

Mr Kell—They think security is important. That is a very important issue for consumers. They do not have any particular concern, in our experience, as to how that security is delivered at the end of the day, as long as it is there. I think the intricacies of capital adequacy rules and those sorts of things are not of direct relevance to most consumers. If they can be told, 'Your money is being properly looked after; it is secure,' then that is what most of them want to know. Let's be blunt. They do not have the financial sophistication or an interest to go many steps beyond that level of knowledge.

Senator MURRAY—Is there any way in which you are able to determine how many of your 200,000 members are investors?

Ms Bun—We do surveys before we do stories or produce books. On the basis of those surveys, we determine levels of interest. As Peter said, in terms of financial services relative to other areas, it is pretty much at the very top. They are more interested in that than food or—

Senator MURRAY—It would be a substantial number of your members.

Ms Bun—A very substantial number.

Mr Kell—Yes. I cannot remember an exact percentage, for example, as to how many are in unit trusts, but it is a popular issue. There are no two ways about that.

Senator MURRAY—To arrive at your opinion, did you do detailed surveys or focus groups with these investors who are your members?

Ms Bun—Actually, no. We do not have the resources for every policy issue to conduct focus group research or detailed internal research. We are, after all, funded in order to produce information for our subscribers. How we achieve a policy position is to, firstly, understand the broad issues in the context of the consumer rights that broadly exist—the right to information, the right to choice, et cetera. We then canvass what is happening in other countries and sometimes hold discussions with other consumer organisations. We certainly discuss with other stakeholders like the Australian Shareholders Association. We get letters all the time from our subscribers and we respond to those and have interaction.

Mr Kell—And trustees and fund managers visit us as well.

Ms Bun—All the time.

Mr Kell—On that issue, we have surveyed our subscribers on a range of investment issues and asked them, 'What concerns you in these areas; what do you want to know about; what the issues do you see that we should be looking at in *Choice*?' Inevitably, it is issues such as, 'What is going to be the best investment in terms of return; should I be in these sorts of shares versus another; how do I choose a superannuation fund?' There are a whole lot of things that they are interested in.

The issue of 'I want my fund manager to hold assets in this particular fashion' is not one that comes up at all. On the other hand, they have very, very strong memories of things like Estate Mortgage and Aust-Wide.

Senator MURRAY—Do you have advisory committees or any expert group in these areas that you refer to?

Ms Bun—We regularly consult with a range of academics and certainly industry associations from their own submissions point of view. We have a council, and that council includes some very eminent research folk in the area of financial services as well as general consumer protection. We do not have a formal committee whose role it is to formulate policy on financial advice.

Senator MURRAY—Or to represent the members? There would not have been a group of your members which would have examined this bill and advised you of their feeling about it?

Mr Kell—No. Your average consumer would not look at a bill like this. That is expecting a lot.

Ms Bun—They would have no idea.

Senator MURRAY—So how do you come to this view on the management investment bill? How many people would you have interacted with?

Mr Kell—Far too many on this one, frankly.

Ms Bun—And too much time.

Mr Kell—As I said, we survey subscribers about the issues that they see are important in the investment area all the time; we talk to industry players; we talk to other groups representing investors; we talk to regulators. We have had briefings from the ASC; we have had lobbying from both sides in the debate; we have talked to the political players. I am hoping it all ends very, very soon.

Senator MURRAY—Have you balloted your members and said, 'Here are essentially three models. Here is a single responsible entity model, here is the current model and here is a model of choice'?

Ms Bun—Senator Murray, we have not. That is because we represent at an expert policy level the interests of consumers who often do not have a clear understanding of the range of complex issues involved. For example, we have made comment before committees in the last six months on issues ranging from telecommunications reform to the Wallis set of arrangements and so forth—very complex regulatory issues. We do not make policy on the basis of a democratic vote of people who subscribe to *Choice* magazine.

CHAIR—It is more your role to advise consumers than that consumers advise you?

Ms Bun—Yes, that is right. We are simply providing information.

Mr Kell—The final thing on that issue is that, if I can say so with all due respect, there are about 20 other issues in the financial services area that we are devoting more effort to than whether there is a mandated custodian or not, because we see them—given our limited resources—as more significant, such as some of the reforms going on in the superannuation area.

Ms Bun—Superannuation choice and so on.

Senator MURRAY—The committee has heard from a number of other lobbying groups who, with their constituent members, have received submissions and have arrived at an

opinion. In some cases they are unanimous, and in some cases not entirely. It is difficult for me to accept that you represent all investors if you have not asked all those investors the question. I appreciate that it is difficult to convey a bill, and you have clearly outlined your difficulties. But I think we will leave that there. Have you carried out any studies on the cost savings that will flow to investors because of this bill?

Ms Bun—It is very difficult to make assumptions about cost savings flowing to investors without making very rigid assumptions about the extent of competition. No, we have not modelled those out. So we do have concerns that, in the absence of great scrutiny and effective competition, to the extent that there are cost savings there is a risk they may not be passed on. However, we think there is a shot that they may. So we think it is worth trying.

Senator MURRAY—I am advised—but I do not know—that when the S(IS) Act came in, trustees were made to retire from public office superannuation funds. I am advised that most managers—and I repeat, I do not know this; this is what I am told—retained the trustee fees themselves, rather than passing them on to investors. My knowledge of business people is that if they can make an extra dollar, they will take an extra dollar. Is there a danger, in your view, that that will occur with this change?

Ms Bun—Yes. There is indeed, and you point precisely to the issues associated with the rigidity of the superannuation system and its inability to actually offer changes through competition. After all, it is a compulsory system.

Senator MURRAY—So you would be keen, I would assume, to see any amendments which ensured that cost benefits from this bill were passed on. Wouldn't you?

Mr Kell—We have certainly said that in all the comments we have made on this issue. We have put that quite specifically to the ASC, that we would like to see monitoring of the costs issue. It is something that we have taken as a very strong issue. We support a very close scrutiny of the costs.

Senator MURRAY—Because of the nature or the scope of the funds that are involved in this inquiry, I will pose you the billion-dollar question—it is not the $60,000 question; it is the billion-dollar question—which we have asked both fund managers and trustees. Is it your considered opinion that investors will be better protected under this bill, or make more money under this bill, or lose less money under this bill, than under the present regime?

Ms Bun—We would not support the concept of a single responsible entity with the caveats of an effective regulator that is properly funded, unless we believed that net benefits will accrue to consumers, both in terms of security in the longer term and in terms of cost efficiency.

Senator MURRAY—So you think the view put to us by a section of the witnesses, that investors will be less protected, is wrong?

Ms Bun—We do.

Senator MURRAY—Thank you, Mr Chairman.

CHAIR—Mrs Johnston.

Mrs JOHNSTON—Andrew has just asked my question—two minds thinking alike! Thank you.

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

[10.42 p.m.]

MARTIN, Mr Geoffrey Ian, Chief Executive, BT Funds Management Ltd, Level 15, Chifley Tower, Chifley Square, Sydney, New South Wales 2000

O'REILLY, Mr David John, Legal Manager, Bankers Trust Australia Ltd, Chifley Tower, 2 Chifley Square, Sydney, New South Wales 2000

CHAIR—Welcome. Do you have any comments to make on the capacity in which you appear?

Mr Martin—I am chief executive of BT Funds Management and chairman of the Global Investment Management Group of Bankers Trust. It is in that capacity that I appear. I am also the chairman of the Investment and Financial Services Association.

Mr O'Reilly—I was formerly with the Commonwealth Attorney-General's Department and then the Department of Treasury.

CHAIR—Mr Hartnell is also here. Do you wish to give evidence at this point, Mr Hartnell?

Mr Hartnell—Could I put a seat between me and the funds management business. I am not here in support of or representing the funds management business; I feel I should make that clear. I am not being paid by anyone for the benefit of the Australian Consumers Association. I am here as an interested private citizen who has followed this debate for most of my life.

Mr LEO McLEAY—Would you prefer to be dealt with on your own, Mr Hartnell?

Mr Hartnell—I would.

Mr LEO McLEAY—Why don't we do that, then?

CHAIR—Yes, that is fine, if you would prefer that. Mr Martin and Mr O'Reilly, would you like to make an opening statement?

Mr Martin—Mr Chairman and members of the committee, I cannot help thinking that over the last few weeks there has been an extraordinary amount of misinformation and confusion bandied around in public about what the Managed Investments Bill 1997 will or will not do. We are clearly in the midst of a carefully orchestrated scare campaign by the trustee companies and others, many of whom have a direct business relationship with the trustee companies.

As somebody who has had responsibility for managing a major fund management firm for a decade and whose responsibilities now have a global reach, I believe we must not lose sight of the undeniable fact that, on any analysis, the current system has been found deficient over and over again. While the reasons for that are complex, a fundamental problem is that the system just was not designed for the environment that we are now in. The existing regime dates back decades and grew out of the regulation of private trusts and the simplistic regulatory notion that a public trust should have a public trustee.

Managed investments now play a pivotal role in marshalling savings investment in our economy. It is appropriate that the regulatory regime be modernised to equip it for the circumstances of that environment. While regulation of the banks, insurance companies, consumer credits, superannuation and so on has been modernised and reformed, managed investments continue to operate in a regulatory regime stuck in a time warp.

Extraordinarily, this has occurred despite the fact that the need for reform has been long recognised, including by such eminent expert bodies as the Rae committee in 1974, the Campbell committee in 1981, the Companies and Securities Law Reform Committee in 1988 and the NCSC in 1990. All recommended full-scale reviews of the regulatory framework for managed investments. Since then, we have also had the monumental failures of Estate Mortgage and Aust-Wide. It is now almost five years since the Law Reform Commission CASAC report and one year since it was further endorsed by the Wallis report. We now finally have a coherent piece of reforming legislation agreed on in all but one detail by the major political parties and supported by almost every significant financial institution which does not depend on trustees for its prosperity.

The bill also has the support, as we have heard, of the Australian Consumers Association, the Australian Shareholders Association, the Financial Planners Association, the ASC and most senior practitioners in the field. What the Managed Investments Bill will do is deliver an efficient and cost-effective system of regulating managed investments. By removing the confusion inherent in the current regime about the relative responsibilities of trustees and managers, it will make it much easier for investors and, if need be, the courts to sheet home responsibility.

Moreover, as the Chairman of the ASC pointed out in his comments to this committee on the bill, it provides for an integrated approach to regulation. It replaces the existing and anachronistic hodge-podge, and the confusion about responsibilities which is part of it, with very clear accountabilities and a comprehensive series of checks and balances which will actually enhance the degree of investor protection. I am, of course, referring to the entire regulatory package encompassed in the bill, including the licensing and regulation procedures, the clarification of fiduciary obligations, the requirement for a compliance plan, an independent compliance committee or board, additional responsibilities on auditors and so on.

What the bill does not do is abolish or in any way undermine the trustee role. Replacing the present system of dual responsible entities is not synonymous with abolishing trustees. On the contrary, the Managed Investments Bill codifies the trustees' duties and provides for

them to be imposed directly on those who are genuinely in control. Make no mistake, the single responsible entity is a trustee under the Managed Investments Bill, just as it is under SIS.

To imply, as the Trustee Corporation Association does, that the trustee companies have a monopoly on integrity and competence in the area of investor protection is as insulting as it is demonstrably untrue. Contrary to some suggestions, the bill will not prevent a division of responsibilities which would somehow disadvantage specialist fund managers. There is nothing to stop them from appointing specialists to oversee compliance or to do their administration or to be the custodian. They will, however, be responsible for the appointments they make, which I believe is as it should be.

I have heard comments during the course of the evening about whether or not the bill will in some way diminish prospects for selling Australian products overseas. That is almost certainly not the case. In fact, I think it will improve prospects of selling Australian investment products overseas. The fact that the regime which clearly is deficient has been allowed to persist is detrimental to our responsibilities. The fact that we had Aust-Wide and Estate Mortgage in this country, and that we have taken six or seven years to respond to the problems that that clearly highlighted in our system, is very detrimental to us on the world stage. We should not lose sight of that.

In summary, the Managed Investments Bill will at long last finally give to Australia, in 1998, what the Investment Company Act gave to the United States in 1940: a comprehensive, tailor-made regulatory regime specifically suited to the needs of managed investments and the investors therein. Australian investors and, indeed, the economic wellbeing of all Australians will be better off as a result. I have absolutely no doubt that this legislation will provide for best practice on the international stage. I certainly commend it to you.

I would also suggest that now is the time to take action on this particular piece of legislation. We have had an enormous bull run in financial markets over the last few years. It is inevitable that stresses and strains will re-occur. Australian investors and Australian voters are going to be asking some very hard questions about what went wrong in the political and regulatory process if those problems that manifested themselves six or seven years ago just have not been addressed. Now is the time to address them. Thank you.

CHAIR—Mr O'Reilly, do you wish to add a comment?

Mr O'Reilly—I was closely involved with the development and drafting of the 1995 draft bill. I have been concerned about the misinformation or misunderstanding as to the operation of some of the provisions in that bill and would want to comment or address any questions on the technical issues arising out of that bill.

Senator CONROY—Mr Martin, you probably would not have seen this Trustee Corporation Association submission, because it was only just tabled today. It refers to regulatory structures for collective investments internationally. It only has two countries

listed as 'manager only' in the world—British Virgin Islands and Netherlands Antilles; manager and trustees. Most other countries are manager and custodian in a couple, or one with an independent board of trustees. Would you say that is an accurate reflection of the state of the situation overseas? Would you query this in any way?

Mr Martin—Without seeing the particular document to which you are referring, I obviously cannot comment in an informed way. Let me make a couple of comments. There are in fact a variety of regulatory regimes for collective investments around the world. One thing that frustrates those of us in the industry who are practitioners is the fact that there is very little commonality in relation to the regulatory environment, which makes the cost of doing business across borders extraordinarily expensive. The point that I would make, however, is that our experience with regulators in other regimes is that they actually look beyond the precise details of the regulatory regime or the precise black letter of the law, if you like, and come to some measure of the effectiveness of the regulatory regime concerned.

I think the Chairman of the ASC, in his evidence before this committee, pointed out that IOSCO look for certain principles in regulation. Indeed, I believe that that is the way regulatory bodies behave. I would re-emphasise the point that I made before, that the fact that the Australian regulatory environment has been found wanting, the fact that it has not been modified despite the stresses and strains that manifested themselves in the early 1990s, is of more concern to overseas investors than any particular features of this bill. I have discussed this bill with a number of industry practitioners and others from around the world. I cannot say that I have had an unfavourable response at all. They certainly understand the circumstances in which these actions are being taken in Australia.

Senator CONROY—Are any other countries that you are aware of moving towards the single responsible entity concept?

Mr Martin—The answer to that is no, I am not aware of any particular countries. But, again, as the Chairman of the ASC has pointed out, IOSCO is moving towards setting down principles. I believe that the proposed legislation is in accordance with those principles.

I have sat here and heard people say that there is a requirement in most regimes for an independent custodian. I can tell you that Bankers Trust offers retail financial products, investment products, collective investment schemes, in a number of regulatory regimes around the world, including the United States, including Europe under the uses regime and including Japan, and in all of those cases we have a related party custodian. There is flexibility in the law in those cases. So we need to be very careful about some of the simplistic notions that we are hearing here about what is and what is not the regulatory environment overseas.

Mr O'Reilly—I would also like to make the comment that the unit trust is a common law creature. More than half the world does not recognise the unit trust in their legal system. Civil law countries have, in terms of managed investments, a range of vehicles and a range of different custodial requirements, from simply requirements to use a bank as a depository

to, in other countries, requirements for segregation of assets in the accounts. So it is not correct to generalise in the way that has been done in relation to managed investments globally.

Senator CONROY—I am relatively new to the committee in this area and I thought you might like to respond to an argument that Mr Keavney made. In the case of Estate Mortgage he said it was the fund manager that stole the money or defrauded, not the trustee, and that putting the fund managers in charge as a reward because there was a crook fund manager seemed to be an unusual direction to run in. Would you like to respond to that?

Mr Martin—I was a little curious about that argument. My understanding of the circumstances surrounding Estate Mortgage is that there was in fact a trustee in place and that that trustee was the custodian. So if the manager stole, then clearly that trustee or custodian was not doing his job properly. My understanding of the circumstances of Estate Mortgage is that the manager did act outside of the trust deed and criminal action was ultimately taken against members of the management company as a result of that.

But clearly what also happened in the Estate Mortgage situation was that that situation was not picked up by any of the checks and balances that were in place at the time. The trustee very clearly did not understand or was completely negligent in terms of what was happening in that case. It very clearly demonstrates that the existing system was deficient.

Senator CONROY—I know little about Estate Mortgage. Other members of the committee probably know more. I accept the point you are making. I think you used the word 'negligent' in relation to the trustee, but removing the trustee and leaving the body that was responsible for going outside is really what I am looking for a comment on.

Mr Martin—With due respect, Senator, that is where I think you are wrong. You said removing the trustee and leaving the manager. The Managed Investments Bill encompasses a whole range of checks and balances that replace the trustee. It adds up to a much more comprehensive regulatory regime than the regime that it is going to be replacing. I am sure by now you are well aware of what those checks and balances are. Requirements for an independent board, a compliance plan, an increased role for the auditors, additional power to the regulator, the licensing procedures, the scope for additional criminal sanctions against directors and officers of the company, and so on, I believe all add up to a much more effective regime than the dual regime that we currently have.

Mr LEO McLEAY—Mr Martin, what is the difference in costs, say, between the current regime of a trustee and the additional costs there will be with these supervisory boards, external directors and auditors, et cetera? Has there been any quantification of that?

Mr Martin—There has been some quantification. The Investment and Financial Services Association has surveyed its members. Based on that survey, which was undertaken by Price Waterhouse, there has been an estimate of savings in the order, I think, of $19 million. Perhaps I can talk about the experience of my own company and what we believe will be the

savings that flow from this. We certainly believe that there will be scope for some operational efficiencies.

We also believe that the environment that will be created as a result of the bill will be more cost effective in the sense that it will deliver a more effective regulatory environment at a lower cost. Even in our own case the savings are likely to be in excess of $5 million to $6 million. We have already committed to ensure that those savings do flow through to the end investor.

Mr LEO McLEAY—How will that happen?

Mr Martin—By efficiencies which will impact favourably on fund administration costs, which will result in the management expense ratios of the fund diminishing over time. What you should also bear in mind is that ours is an enormously competitive industry. There are a large number of players in the industry. There are very few industries in the Australian economy that can boast the same sort of intensity of competition. So, almost certainly, competitive pressures in the industry will ensure that those cost savings do flow through to end investors.

Mr LEO McLEAY—So it will drive small operators out of the business?

Mr Martin—No, I do not think it will happen at all. One of the suggestions I have heard as I have sat here today is that, somehow or other, small operators are at some sort of disadvantage because they need to set themselves up as a single responsible entity. You should bear in mind that in any retail market new entrants are at a disadvantage simply because they do not have the benefit of a brand name. I would suggest that the retail funds management industry is no different in that regard.

There are, however, ways and means that new entrants can very successfully gain a foothold in this industry. Typically, the way they do that is by going to some of the established retail financial services organisations who do have brand names and holding themselves out as wholesale fund managers. We have heard from Mr Maple-Brown this evening, and that was one way that Mr Maple-Brown went about establishing his company. There have been several other examples of firms that have set up in the same way in the Australian managed fund industry. That option will continue to be available to them in the future. It is not changed one iota by this particular piece of legislation.

Mr ANTHONY—On the management expense ratio, what is the usual difference between, say, a normal BT fund management fee relative to Perpetual?

Mr Martin—I am not sure that I know the answer to that off the top of my head. I cannot remember what the Perpetual management expense ratios are. Typically, management expense ratios in our industry range from 125 basis points, or 1.25 per cent, to maybe 2.75 per cent. In the case of BT, our management expense ratios vary depending on the precise nature of the fund and the precise features that are part and parcel of that particular fund.

For example, an active international equity fund typically carries with it a higher expense ratio and a higher management fee than, for example, a cash management trust that invests solely in the Australian money market. What I can tell you is that, within that range, BT tends to be a little on the high side of average. That is deliberately where we position ourselves.

Mr ANTHONY—Generally speaking, is it true to say that if you have not got a trustee sort of structure, the expense ratio is less, the spread is less?

Mr Martin—I think there is scope for operational efficiencies under the single responsible entity concept, compared with the existing two-party system. I will give you a simple example of one of the operational inefficiencies that currently arises. We actually deal with two trustee companies. In the case of one of those trustee companies, whenever we engage in a transaction we electronically message details of that transaction to the trustee company; they then re-key that into their system and, in turn, message it on their own automated messaging system to the relevant broker to ensure that the transaction is settled. In the case of the other trustee company, that system is streamlined somewhat. But certainly taking out those sorts of inefficiencies that currently arise because of the two-party structure will result in some cost savings.

CHAIR—As there are no further questions, we thank you, Mr Martin and Mr O'Reilly, for appearing before the committee and answering our questions.

[11.04 p.m.]

HARTNELL, Mr Anthony Geoffrey, 9 Lower Serpentine Road, Greenwich, New South Wales 2065

CHAIR—Welcome. Do you wish to make an opening statement?

Mr Hartnell—Thank you. I have been associated with corporate law reform since the late 1960s and have been involved in almost every major debate in some way or another. I think there have been two major debates in my life. The first one was on the generation of a national regulator for companies and securities, which was solved in 1980 by the establishment of the National Companies and Securities Commission; and I was in fact the last chairman of the National Companies and Securities Commission. The second debate is this one tonight, and that is on the question of the monopoly regulation by trustees—and it is monopoly regulation, and the thrust of my submission to you tonight is going to be built around that theme.

This is my historical perspective on what has happened. Through the 1960s, the 1970s and the 1980s, it was absolute monopoly. The regulation of the prescribed interest provisions was totally vested in the trustee business. In my opinion, they totally failed in that respect and served Australia very badly. But they were very powerful in that position: for example, even to this day, trusts are exempted from the takeover provisions and the regulation of takeovers.

Within the last 10 years, I, as the head of the then national regulator, tried to do something about a failure which has being talked about tonight—a failure of a major trust, which was the Estate Mortgage Trust. The people that opposed the regulator getting involved in that were the trustees. Eventually—and, I believe, contrary to audit regulations—I authorised the payment of government moneys to subscribe for units in Estate Mortgage. It was not many units, I have to tell you, but some: enough to ground the authority of the national regulator to make an application to the court, not as the national regulator but as a unit holder. That shows you the extent of the monopoly of regulation that was vested for prescribed interest and is still largely vested in the trustee business.

The bill that we are debating tonight is about removing that monopoly, about making a competitive marketplace in the regulation of prescribed interests, and about delivering efficiencies in the Australian economy. The hearing tonight has been risk obsessed. We have been concerned about failures all around the place. This committee hearing has not given even one minute yet—and I intend to remedy that, in the short minutes that you give me: I will take a few of Mr Bradley's half-minutes!—to any consideration of the role of prescribed interests or, as they are now talked about, 'managed investments' in the Australian economy and of their position as a possible leader of economic innovation.

If you are talking about the management of funds that invest in stock markets or funds that invest in fixed interest markets, that is fine. That, in fact, has largely been the direction

tonight. But what about those activities that are constituted—and can only be, as a matter of Australian law, so constituted—by collective investment forms that are concerned with risk taking and innovation? What about the development of innovative agricultural investments?

I do not believe for one minute that the trustee business is supportive of innovative agricultural investments. I will tell you what will happen if you persuade a trustee to be a trustee of a managed agricultural investment scheme: you will get a requirement for expert report after expert report after expert report. You will have a much heavier cost burden. I do not believe that is about taking risks. I do not believe that is about innovation. I believe that is about covering backsides. Yet, in agriculture, the essence of the scheme is not that the entity or the custodian holds the property; the essence of the scheme is that the investors hold the property. The essence of the scheme is that those investors put money in and take a direct slice of the property.

It is true, also, in a lot of other innovative activities. It is true, for example, in the development of intellectual property. The most common intellectual property development that Australia knows and has become part of the top five in the world in, I suspect, is film making. That is just a form of collective investment in the development of intellectual property. You can go much further than that in the computer business. It is very common in the entertainment business.

It is about supporting investment forms that enable Australia to be innovative and that contribute to the economy, not about being negative and always worrying about where the last audit report is and when the next expert report will be. You cannot do those sorts of schemes efficiently under any other form than a collective investment form—not a corporate form where investors are not allowed to directly invest in the underlying property. They have to invest in the shares of the company. You cannot do it otherwise.

I want to be part of this and to stand up and strongly commend the government for this bill. It is a major bill. I strongly support it, although there are some parts that, in the minor detail, I would not want to have my name written on. But, in terms of a major companies and securities initiative, this bill is a major companies and securities initiative. The supporters of the bill should be supported by this committee. They should be applauded because the ASC, or the government, is never going to be an adequate prudential regulator, nor is it set up to be able to pick up these things.

The trustee system, in my opinion, has failed. They cannot be adequate prudential regulators. Yes, there is a role for them, in the sorts of investments where you want to make sure that the number one touchstone of the investment is security, safety and audit, checking the dollars and making sure there is no leakage and that the MERs are right. There is a very major role for trustees there. I am not trying to wipe trustees out. But, to go to the extent that I heard tonight—of having for managed collective investments not one major exception to the rule that you should have trustees in there—is simply counterproductive to the economic development of this country. It stands in the way of innovation.

I do not want to take this to extremes. When I said I am independent of the managed funds business, I am; I am not being paid. But I am obviously very sympathetic to them. I support their proposition. I support the bill. I had a lot more things to say, but it is getting late and I am sure you do not really want to get into the interstices.

CHAIR—Thank you, Mr Hartnell.

Mr LEO McLEAY—You made a significant point that you are independent of the managed funds business, Mr Hartnell. But have you ever received any remuneration from the managed funds business?

Mr Hartnell—Yes, of course I have. I am a solicitor in private practice and—

Mr LEO McLEAY—Do you currently receive any remuneration from them?

Mr Hartnell—Not that I am aware. My firm may be engaged in some matter or other, often with Bankers Trust. I do not want to—

Mr LEO McLEAY—You are with Bankers Trust?

Mr Hartnell—No. I am a solicitor in my own firm in private practice. The firm is called Atanaskovic Hartnell. I practice as an independent solicitor and I take clients where I can get—

Mr LEO McLEAY—Is one of your clients Bankers Trust?

Mr Hartnell—Of course. I do not want to overstate the—

Mr LEO McLEAY—Do you sit on any Bankers Trust subsidiary company boards?

Mr Hartnell—No.

Mr LEO McLEAY—Have you ever done that?

Mr Hartnell—Have I ever done it? Many years ago, when I was a partner of Allen Allen and Hemsley, I sat on some what I would call shelf company—probably imprecisely—boards. We are talking 10 years ago.

Mr LEO McLEAY—So currently Bankers Trust are a client of yours?

Mr Hartnell—Not a very big one. I would say quite a small one.

Mr LEO McLEAY—But they are a client of yours?

Mr Hartnell—A client of the firm, yes.

Mr LEO McLEAY—So you are not particularly an uninterested bystander here tonight?

Mr Hartnell—I am very interested. If you did not get the message, I am very much in favour of this bill. I am an interested supporter.

Mr LEO McLEAY—But well connected to Bankers Trust, who have just given evidence to us and who you suggested to the committee you wanted to have nothing to do with. But you are in a financial relationship with Bankers Trust.

Mr Hartnell—Excuse me, I did not want to overstate it. I did not—

Mr LEO McLEAY—Well, you made a big production of it. You sat back there and you said at the end of your submission, 'I have got nothing to do with them. I am entirely independent.'

Mr Hartnell—No; with respect, I said that I did not want to be seen to be making submissions tonight as part of the funds management business. And I am not.

Mr LEO McLEAY—Though you work for them?

Mr Hartnell—They are clients. We do work for trustees—although, after tonight, probably do not!

Mr LEO McLEAY—So now we have sort of established that you are not all that uninterested in this.

Mr Hartnell—If I said the funds management business provided my firm with five per cent of its income, I suspect it would be an exaggeration.

Mr ANTHONY—And the trustee business?

Mr Hartnell—Much less.

Mr ANTHONY—After tonight or before!

Mr LEO McLEAY—What you have said to us tonight is that you think we can have a better regime for risk funds?

Mr Hartnell—I think the managed funds bill—I heard Jill Segal say it tonight and I totally agree with it—gives much greater flexibility to deal with secure funds in this way, and with innovative funds in this way, and it should be allowed to develop as such. That is the genius of the bill. This inflexibility of saying, 'No, everything should be treated as having trustees and everything should have custodians,' as I have also heard tonight, is contrary, I submit to you—whether I am biased or not, whether I am getting my funding from funds management business or not—

Mr LEO McLEAY—You just said you were.

Mr Hartnell—It is contrary to the interests of Australia. If we are going to survive, we need flexibility, and part of the flexibility is a much more competitive regulatory system, not a monopoly regulatory system for prescribed interests with trustees.

Mr LEO McLEAY—But isn't your argument one that suits a better informed investor? You would probably not made a dud investment. I would be more likely to make a dud investment, because I might not know the intricacies of the market in the way that someone like you would. And one of my constituents might make even a worse investment than me.

As Senator Cooney asked one of the witnesses the other day: where does the boilermaker from Broadmeadows go when dealing with these matters? At least a boilermaker from Broadmeadows, if there was a trustee involved, would have a feeling that there was some protection for him. I think you yourself said that there is more security in an operation that has a trustee involved.

Mr Hartnell—Yes, of course. I am not arguing against trustees—just the trustees having the monopoly of the regulatory system.

Mr LEO McLEAY—One of the problems the parliament has in dealing with this legislation is the government's view that we should be creating a country of mum and dad investors. We have to set up a system with maximum protection and security for those people. To be going in the opposite direction and setting up, in your own words, something that might be more innovative and available to risk might not be the best thing for those people. It might be all right for you and your other clients, but it might not be all right for the boilermaker from Broadmeadows or the shop assistant from Campsie. They cannot afford your fees like Bankers Trust can.

Mr Hartnell—No. That is true. I am prepared to concede to you that I get more fees from Bankers Trust than from boilermakers in Bankstown.

Mr LEO McLEAY—That is mixing my example.

Mr Hartnell—I am not arguing against a system that permits and indeed, through the government regulator, requires high supervisory standards in managing what are put to the

public as secure investments. I believe this bill imposes very high standards—much higher than have existed ever in this country to this day and much higher than, as a matter of law, currently exist in Australian law. I believe that to be the case. In relation to some areas of the economy, including small business, if you like, where I am very heavily involved, I know that innovative agriculture, for example, requires support from the collective investment area. I know they cannot get off the ground with the sorts of regimes that trustees—and now, presumably, you—would impose on them. I know that. I say, 'What are you trying to win here? Who are you trying to stamp out? Why are you trying to do that in relation to those sorts of investments?' Here is a bill that delivers both ends of the spectrum. That is its beauty. It is a very sensible balance. I congratulate the people who put it together.

Mr LEO McLEAY—You sound like you had a bit to do with it.

Mr Hartnell—To be fair, I did. But I did not have anything to do with it recently. I certainly was the person who promoted the reference going to the Law Reform Commission and the companies and securities—

Mr LEO McLEAY—You have got more fingerprints on this in more different ways than most other people.

Mr Hartnell—That is fair. But let me tell you, there are areas that I would strongly argue should be exempt.

Mr LEO McLEAY—Could I take you back then to your previous position in the bureaucracy? One of the other thrusts of governments then and now is to try to harmonise our systems with our trading partners and neighbours. One of the pieces of evidence we have heard here from a number of people about this piece of legislation is that it is different from the systems that are in our region. It is even different from the New Zealand system where Australian governments spend a great deal of time harmonising the market to create a larger trans-Tasman market. In your expert opinion, does this piece of legislation work against harmonisation? If it does, what effect will that have on Australian companies doing business, both in the region and with the rest of the world?

Mr Hartnell—The current law is totally opposed to harmonisation—totally. There is no harmonisation under current law. This law is not much better; it is a bit better but not much. The big push for harmonisation comes out of the recommendations of the Wallis committee which, I have to say, I strongly support as well—namely to open Australia up to a much greater range of collective investment products as a competitive means. That is to help make Australia much more cost-efficient in delivering financial services and much more innovative. If that is the case, you are going to have the market find a balance of prudential regulation—that is private prudential regulation—and this bill helps that process.

Mr LEO McLEAY—But not much?

Mr Hartnell—The present law is a positive total brick wall to it. If the present law is a 10-foot brick wall, this bill is a nine-foot brick wall.

Senator CONROY—You mentioned you had been involved in them all and you would know the original bill started out in 1995 with a custodian. Did you support that as passionately as you are supporting this bill?

Mr Hartnell—I was not a great supporter of the compulsory custodian idea because frankly I just see it leading to the need to make more and more exemptions. That is going to be the practical reality on the ASC. They are going to make more and more exemptions unless you prevent them doing it. If you prevent them doing it, you are cutting off your nose to spite your face.

Senator CONROY—Do the exemptions provide the flexibility you are talking about?

Mr Hartnell—That is the only flexibility we have, but remember it is an exemption. It is not an alternative law making power. That takes you from a rule of law to nothing. That is not a terribly satisfactory position to be in particularly for the ASC. It means the ASC has to subtly make law by issuing policy directions, which we all know do not have the force of law. Then lawyers like me challenge them because that is what lawyers do. We spread confusion about the nature of law.

Senator CONROY—You mentioned earlier that there were some bits that you would not want to sign your name to. Do you want to fill us in?

Mr Hartnell—I will tell you but—

Senator CONROY—This committee is investigating the bill as it stands right now. We are interested in areas where you would be unhappy as well as just where there is a theoretical principle that you are happy with.

Mr Hartnell—I came here to strongly support the bill and I am happy to live with the bill as is. If I had the power to legislate, I would reduce what I call regular interference in the operation of managed funds given by the bill to the ASC. I would rely on independent auditors, the independent directors and the compliance systems that are required to be developed. I would increase both the resources and the powers of the ASC in relation to investigations when it became clear that there was a possibility that something had gone wrong, because I think it is a much more efficient use of resources.

Mr LEO McLEAY—Mr Hartnell, you are saying you would make the bill even less prescriptive that it currently is in that area?

Mr Hartnell—In that respect. But it is minor. I do not want you to be taking that message from me that I want a—

Senator CONROY—Would they be the areas you would exempt that you were referring to before?

Mr Hartnell—Areas I would exempt?

Senator CONROY—Yes.

Mr Hartnell—No.

Senator CONROY—You made a reference to areas you would exempt.

Mr Hartnell—I think that if the bill is passed in its present form, the ASC will be forced into making very significant areas of collective investment subject to exemptions. That will, in my opinion, serve a policy purpose without parliament understanding the bottom end of the market—because there is a need to regulate the bottom end of the market as well as the top end of the market. There is a need to regulate agricultural schemes. A lot of people in this country own racehorses. Racehorses are just collective investment schemes. Racehorses are regulated by this bill just as much as—

Mr LEO McLEAY—Because they never make any money.

Senator MURRAY—And produce as much manure.

Mr LEO McLEAY—They are designed to make a loss, aren't they?

Mrs JOHNSTON—Very expensive.

Mr ANTHONY—You mentioned that one of the reasons why you are pretty passionate about this is that it sort of reduces that monopoly regulation and makes a bit more flexibility. As we all know, the previous government reduced a lot of monopolies. They opened up competition in banking in the 1980s and they did it in telecommunications with Optus. They were quite open to competition. Of course, they supported and introduced this bill. Perhaps I could pose the question: why do you think there are some members of the committee who are very resistant to this?

Mr Hartnell—The truthful answer is I have been told in Sydney that there are. I do not know whether there are or there are not, as a matter of fact. I thought I would come and make a submission just in case there were.

Mr ANTHONY—Do you want to elaborate any more on that?

Mr Hartnell—Not really.

Mr ANTHONY—I am quite ignorant of these matters. I am only a new member on this committee, so I am quite ignorant, but I would like to learn from your wisdom.

Mr Hartnell—It is not wisdom. It is practical politics, isn't it?

Mr LEO McLEAY—What do you mean by that?

Mr Hartnell—It is practical politics, if you feel strongly about something, to actually say it.

Mr LEO McLEAY—No, what you said before. Your previous comment.

Mr Hartnell—My previous comment?

Mr LEO McLEAY—In answer to Mr Anthony's first question.

Mr Hartnell—'How did I reach the view that there may be some members of this committee resistant to change', by which I interpreted him to mean how did I reach the view that there may be some sympathy in the parliament to retain the present system, which is what I understand the trustees are arguing for. My truthful answer was: that has been the subject of discussion—and no higher than gossip—in Sydney.

Mrs JOHNSTON—You have talked a lot about flexibility. You would obviously like to see or think that this bill provides the choice that is required for these sorts of transactions to happen in a much better way?

Mr Hartnell—Which sort of transactions?

Mrs JOHNSTON—We were talking about managed investment funds.

Mr Hartnell—Yes. I think the regulatory environment should be—

Mrs JOHNSTON—Would you like to see more choice? You would obviously like to see less regulation and more choice?

Mr Hartnell—No. I am not saying that. Not less regulation and more choice. I am saying more flexible regulation, and when you are talking about large dollops of very real money seeking conservative homes, a lot of regulation. Do not take me as saying that I want less regulation in that area. But I want more flexible regulation.

Mrs JOHNSTON—More flexibility.

CHAIR—And this bill provides that?

Mr Hartnell—This bill is a wonderfully flexible instrument.

CHAIR—Are there any further questions?

Senator MURRAY—Mr Hartnell, is Bankers Trust rated by any credit agency, such as Moody's or Standard and Poor's?

Mr Hartnell—I imagine they are, but I do not know.

Senator MURRAY—I ask the question because, if you want to know whether to invest in a bank or a country or, often, big companies, Moody's or Standard and Poor's will rank them. Good companies of good countries are very attentive to their ratings. It affects the cost at which they acquire money, and all those sorts of things. The reason I draw that analogy is that, for the range of investors which you have clearly outlined—from those who are interested in high risk and innovative activities down to those who want to be secure and just get a guaranteed return—it is difficult to know how funds are rated, and there is no provision in this bill for the ASC, for instance, to grade all funds.

So, if you wanted high risk and high return, you might go for somebody rated P. If you wanted to go with low risk and guaranteed return with a trustee attached, you might go for some other thing. What would you think of some kind of system which would make the marketing of policies and of the different products you were referring to more understandable by investors?

Mr Hartnell—I would applaud it, but I would say it was an extremely difficult task—extremely difficult, if not impossible—because, in selling what is roughly a generic product, you only sell it by product differentiation, as with cigarettes. The same is true in the retail financial products business. The weighting of the features that any fund may have, as against another fund, would be very difficult to put into some objective rating system.

Senator MURRAY—I might give a different analogy. I might say it is like a car. A car is a generic product which takes you from A to B, but it is very easy to rate in terms of safety—airbags, and good structure in the chassis—or cost and so on, and motoring magazines do that for buyers of motorcars. They rate them. What the parliament is looking for is to ensure that the end of the market that requires and needs the most certainty, the most security and the least risk is catered for in this brand new world. The parliament is very comfortable with those who are informed and can make the high risk and innovative judgments on things which you rightly propagate as a good product to have. But it is the other end and the means of determining choice and making choice available to the investor in an understandable form which are exercising our minds.

Mr Hartnell—Rightly so. I understand why that is exercising your mind. I just think it is an incredibly difficult task to come to an acceptable and common standard on it.

Senator MURRAY—Would you think it an appropriate task to ask the ASC to try and accomplish, or would you rather leave it to the market?

Mr Hartnell—I would not think the ASC expert enough to do it. I really do not think they are expert enough. By all means, mandate the ASC to study it and come up with a proposal for debate; but to actually require the ASC to do it cold, as it were, would be—

Senator MURRAY—In one sense, though, the bill does require them to do that, does it not? It says that they should, at their discretion, appoint a custodian where they think it appropriate. That is almost equivalent to saying that either the fund manager is a little dodgy in terms of capital adequacy or expertise, or whatever the ground is, or else that that particular class of investors might need the extra certainty that a trustee would provide.

Mr Hartnell—It is a very powerful weapon for the ASC to require a fund manager to appoint a custodian, because it would be done in the full glare of publicity, with some sort of reason. The ASC would be treading very carefully. It is like fingering someone and saying, 'You're not long for this industry.'

Senator MURRAY—There are two approaches to this. The approach of the ASC, if the bill were to give them the power, would be for everybody to have a custodian, and then they exempt the high-risk, innovative, aggressive, well-managed and well-operated operations. The alternative is what the bill proposes, that nobody gets one, and then they appoint as they see fit. That is a much more lengthy process because, with their resources and so on, they would have to take time to examine the issue and arrive at a conclusion, which would leave a lot of people out; whereas I would expect that people like your clients, Bankers Trust, if there were provision for an exemption, would knock on the door the next day with their portfolio, and the ASC would say, 'Certainly: you fit the bill, so off you go: you have got an exemption!'

Mr Hartnell—If only! I have applied to the ASC on behalf of a major financial institution in the world for an exemption almost two years ago. I sometimes wonder whether they have actually opened the letter!

Senator MURRAY—It was different in your day?

Mr Hartnell—It certainly was. If only we could get an exemption overnight!

CHAIR—Any further questions?

Senator CONROY—I am not from Sydney, so I miss out on Sydney gossip.

CHAIR—I do not think we need to discuss any more gossip, Senator Conroy.

Senator CONROY—I am wondering if you would tell us which members of the committee you were told were opposed or were resisting change.

Mr Hartnell—You want me to finger members of the committee?

Senator CONROY—Yes.

Mr LEO McLEAY—Absolutely!

Mr Hartnell—I am not going to.

Senator CONROY—This is a parliamentary committee: you have appeared before them before and you understand the forms. It is the next question that you have to worry about!

Mr LEO McLEAY—I think you should be asked to answer the question.

CHAIR—The witness can answer the question in the way that he determines.

Senator CONROY—This is not estimates, and he is not a minister.

Mr LEO McLEAY—Mr Chairman, if a witness decides he wants to come in here and make a fairly significant allegation against members of the committee, he ought to be willing to substantiate it.

Mr Hartnell—But I do not remember making an allegation.

Mr LEO McLEAY—You did. You said that you came along here because you had heard gossip in Sydney that people on this committee were opposed to the bill. That is what you said. Do you want it read back to you from the *Hansard*? So who are the people?

Mr Hartnell—Perhaps I put it too broadly in saying 'people' in the sense of precise people—

Mr LEO McLEAY—'Person', then: who is the person?

CHAIR—Do not badger the witness, please.

Mr ANTHONY—I found the answer quite satisfactory, actually.

Senator CONROY—We did not.

CHAIR—It was your question, wasn't it, Mr Anthony?

Mr ANTHONY—Yes, and seeing that it was my question, I appreciate that—

CHAIR—If Mr Anthony is satisfied with the answer—

Senator CONROY—I have asked a question.

Mr LEO McLEAY—We have asked a further question here, and we want an answer.

Senator CONROY—I actually have another question that I would like to ask, Mr Chairman, in due course.

CHAIR—Please let the witness respond without being badgered.

Senator COONEY—He is taking his time.

Mr Hartnell—The further question is the precise names I was told were opposed to the bill.

Senator CONROY—No, that is not the question.

Mr Hartnell—That isn't the question?

Mr LEO McLEAY—There were two questions: the precise names, and who told you them.

Mr Hartnell—Oh. Right. Well, I do not believe I was told any precise names. I believe that it may have been said to me that the Democrat members of this committee were not supportive of the bill.

Mr LEO McLEAY—It 'may have been said', or it 'was said'?

Mr Hartnell—It may have been said to me, in that sense. I did not take such notice of the comment as to record it because I believed I was going to—

Senator CONROY—You felt it necessary to come just in case there was, you said.

Mr Hartnell—I feel strongly in support of the bill.

Mr LEO McLEAY—And indeed your answer to Mr Anthony was 'I will honestly tell you'—that is what your words were. 'I will honestly tell you it was put to me in Sydney that people on the committee were opposed to the answer.' It was not just you saying, 'Well, probably people on the committee are opposed to the bill.' You said, 'I will honestly put it to you. I will honestly answer you,' and you said it with a quiet little aside to us. If you want to relate gossip, you had better be game to stand up for it.

Mr Hartnell—Well, I did not actually want to relate it.

Mr LEO McLEAY—But you did.

Mr Hartnell—I am sorry; I was asked a question. I did not volunteer it.

Mr LEO McLEAY—And, in answering the question, you related what you said was some gossip in Sydney about members of the committee. If you want to do that and if you want to impugn the motives of the people on the committee, you should be willing to stand up for yourself.

CHAIR—Hang on! Order!

Mr Hartnell—I am not impugning the motives of people on the committee. We are having a debate about a public policy in Australia, and everyone on the committee is entitled to have an opinion, and I have an opinion. I came to express my opinion in the hope that it would participate in the debate with other people's opinions. I am not—

CHAIR—Imputing motive.

Mr Hartnell—I am not suggesting anyone's motive is in any way impure. We are having a policy debate.

Mr LEO McLEAY—You are suggesting that Senator Murray is somewhat ingenuous in the questions he has asked you because he has a closed mind on the matter.

Mr Hartnell—I am sorry; I did not say anything about a 'closed mind'.

Mr ANTHONY—Mr Chairman, as I was the one that asked the question, I do not think it is appropriate to unnecessarily intimidate witnesses and I found the answer quite satisfactory—

Senator CONROY—And I have asked a second question.

Mr ANTHONY—Considering that the witness has answered it, I think we should move on to more substantive issues, quite frankly, as the night is moving on.

Mr LEO McLEAY—I bet you do, now!

Senator MURRAY—I did not take offence.

CHAIR—Senator Murray indicates he is not taking any offence, and so I do not think we need to pursue the matter any further.

Mr LEO McLEAY—Senator Conroy had a further question.

Senator CONROY—You actually asked it for me.

CHAIR—Was it a question of substance or a question on gossip?

Senator CONROY—Who put it to you about members' views?

CHAIR—I do not think that is relevant, either.

Mr LEO McLEAY—It is a question asked by Senator Conroy and it is a question that deserves an answer.

CHAIR—Are there any further questions?

Mr LEO McLEAY—Mr Hartnell wants to answer the question.

Senator MURRAY—If I can make an observation, I think you should inform your informant that he or she is mistaken. Mostly it is a suits industry, I gather.

Mr Hartnell—Can I say that I am pleased to hear it? I was concerned that there was a possibility that this bill would not be passed—not because I thought anyone was doing anything wrong, but because I thought it was the wrong thing for Australia.

Senator MURRAY—But you should also tell your informant that I would like to amend it quite heavily.

CHAIR—Are there any further questions?

Mr ANTHONY—You mentioned agriculture initially, which is dear to my heart. Maybe you could elaborate on how you see that sector of industry being more encouraged by these particular changes.

Mr Hartnell—Agriculture is a classic example of a collective investment, where the investors want to actually own the property: not the trustee owning the property, not a company owning the property, and not a custodian owning the property, but the investors owning it. They want to own the farm. They want to own a share of the tractor. They want to own the crop or whatever it is. The only form of collective investment vehicle available to them is the one we are debating. At the present time, it is very heavily constrained. It is constrained partly because everyone—I should not say 'everyone', because I will be asked to name them!—

Senator MURRAY—You can name me again, if it makes you comfortable.

Mr Hartnell—It is partly because there is a perception that investment in agriculture is to avoid paying tax and therefore is a socially undesirable activity, and therefore it does not matter that we have a regulation of collective investment that is disadvantageous to collective investment in agriculture, particularly in horticultural schemes. It does not matter, because it is like smoking: we are getting rid of it. It is tax avoidance. Under the present system, we insist on the major costs of trustees, trust deeds and managers with securities industry background. You should read the form for becoming a licensed dealer at the present time: in order to run a collective investment vehicle to grow tomatoes, a licensed dealer has to specify a lot about how much experience he has in the share market, but he does not have to say one word about how much experience he has in the tomato business! I am sorry if I have missed the question.

Mr ANTHONY—I have one further question. Obviously, there are many interests involved here, and I can certainly appreciate the concern that the trustee companies have, because potentially they could be in a position where they may be losing a percentage of their revenue and a percentage of their business. How do you think that they will adapt—if they can adapt? What sort of future will these organisations have if this bill is passed?

Mr Hartnell—I really do not know how they would adapt. I wonder to myself—and they can answer and say how innocent I am!—why it is that some of the most reputable names in collective investments in Australia do not actually go into funds management themselves, by taking advantage of this bill, and do not become a competitive force in it. I wonder why that does not happen. But they—and not I—can tell you.

CHAIR—As there are no further questions, we thank you very much, Mr Hartnell, for appearing before the committee and particularly for answering our questions.

Senator MURRAY—And entertaining us late in the evening.

Mr Hartnell—Chairman, I would like to say one thing, because I am sure Mr McLeay would like to devil me a bit on it. I answered directly and honestly a question which he asked—namely, had I ever been a director of a subsidiary of Bankers Trust. I am a director. Indeed, I am chairman of three companies that carry the name Bankers Trust; but as far as I am aware Bankers Trust does not own one share in any of them. I suspect that was what was behind Mr McLeay's questioning. They are three publicly listed companies. I say that just by way of full disclosure.

Mr LEO McLEAY—What was behind my questioning, Mr Hartnell, was that you were put in the bracket of people who were appearing before us as representatives of Bankers Trust.

CHAIR—No: as representatives of people supporting the bill.

Mr LEO McLEAY—And they were all from Bankers Trust.

CHAIR—No. We had the Consumers Association—

Mr Hartnell—Bankers Trust is a leading advocate of the bill.

Mr LEO McLEAY—The three people who sat down were Martin, Hartnell and O'Reilly.

CHAIR—And Mr Hartnell immediately said, 'I am not with these.'

Mr LEO McLEAY—Martin and O'Reilly were from Bankers Trust and, as it was originally bracketed on our paper, it said that you appeared with the same people—just a little bit of simple detective work!

CHAIR—Mr Hartnell, you are excused.

Mr LEO McLEAY—I know you are principal of a big law firm in Sydney, and you seem to know them pretty well.

[11.53 p.m.]

MURPHY, Mr James, First Assistant Secretary, Head—Business Law Division, Treasury, Parkes Place, Parkes, Australian Capital Territory

PATCH, Mr Robert Gordon, Senior Adviser—Business Law Division, Treasury, Parkes Place, Parkes, Australian Capital Territory

CHAIR—Welcome. Do you particularly want to make any comment on this bill?

Mr Murphy—The managed funds bill?

CHAIR—Yes.

Mr Murphy—I might make some brief comments. I am the officer who has been principally responsible for the preparation of the bill since the commencement of this exercise. I was in Attorney-General's when the reference was given to the Law Reform Commission.

I was a consultant, as were many others, with the Law Reform Commission and CASAC in the development of the report. When the report was given to the government, I was responsible for the preparation of the bill for Attorney-General Lavarch, and also when there was the change of government. In both instances, I was head of the team responsible for the preparation of the managed funds bill for the Treasurer and Senator Campbell.

In one instance, I will make a declaration of interest. The people who have worked on this bill have been career public servants, who have no particular interest in seeking out anything other than good public policy. What has come through, throughout all the consultations and over all the time, is that the bill represents what is—from a Treasury point of view—the best-designed regulatory system one could have for the future for the managed funds industry.

If the committee gives closest study to the legislative provisions set out in the bill, you will see that there is an interlocking approach, with provisions that ensure and even take to the greatest extent possible the investor protection that one could seek in this bill. The committee should bear some time in looking at the actual provisions of the bill and should not be distracted by the argy-bargy that is occurring between two major parts of the investment funds industry. Other than that, on this bill I am quite happy to answer any questions.

CHAIR—Thank you, Mr Murphy. Is there anything you want to add, Mr Patch?

Mr Patch—No, Mr Chairman.

CHAIR—Are there any questions?

Senator CONROY—Not on this bill. He is talking about management investments; I want to talk about company law reform.

CHAIR—No, we are on managed investments at the moment. Are there any questions on managed investments? Thank you for your contribution on the Managed Investments Bill. I will now close the hearing on the Managed Investments Bill.

Committee adjourned at 11.57 p.m.