28 September 2023

MIS Review
Retirement, Advice and Investment Division
Treasury
Langton Cres
Parkes ACT 2600

e-mail: MISReview@treasury.gov.au

Dear Sir / Madam

RE: Review of the regulatory framework for managed investment schemes (MIS) – Consultation response

I write in response to the consultation paper to inform Treasury's considerations of the matters raised.

Equity Trustees

Equity Trustees was established as an independent trustee and executor company in 1888 and has grown to become one of Australia's leading specialist trustee companies supervising ~$160bn of assets in some thousands of trusts, schemes and funds. By offering a diverse range of financial and fiduciary services, we help private, fund managers and other corporate and superannuation clients grow, manage and protect wealth. Through its subsidiary companies Equity Trustees issues some 321 MIS acting as Responsible Entity for 236 registered managed investment schemes and trustee for 85 unregistered schemes with some $72bn funds under management.

We are the largest provider of independent Responsible Entity (RE) and Trustee services in the sector which gives us a unique position and perspective:

- We do not face the same conflicts of interest as vertically integrated market participants
- By providing trustee services in a number of contexts beyond managed investment schemes we are able to bring a broad insight from aligned fiduciary roles and regulatory regimes
- Our model of oversight over many managed investment schemes (including the most diverse range of structures and asset classes) and utilizing many service providers gives us a unique insight into the operation of the industry that Responsible Entities / trustees of individual or in-house schemes do not benefit from.

In opening, Equity Trustees concur that the nature and complexity of the industry is evolving and supports the premise of Treasury's review in ensuring the regulatory environment evolves to ensure it continues to be fit for purpose into the future.

Equity Trustees would observe that the current framework has stood the test of time and served the interests of investors well over the last 25 years with relatively few failures through a range of market cycles. Notwithstanding, it is timely and appropriate to consider improvements to the framework.

We will not attempt to respond to all questions, rather focus on those of most import and which we have a particular perspective on.

Scheme governance and the role of the responsible entity

1) Majority external Board Directors

Equity Trustees believes that RE Boards should be required to have a majority of independent non-executive board members.

There is little debate that a majority of independent non-executive Directors is considered the preferred and superior governance model for protecting rights and providing independent challenge and oversight to Management. This is true in listed entities where shareholders entrust the stewardship of their company to independent non-executive Directors and likewise in the CCIV regime[1].

While the current arrangements have broadly operated effectively, the Compliance Committee plays a relatively limited role and the Compliance Committee does not have the same powers or responsibilities as the Board, which is important in the event of failure within an RE or serious issue within an MIS. Looking forward the application of best practice governance arrangements will ensure the interests of investors are, and just as importantly, are perceived to be, appropriately protected underpinning investor confidence in the MIS industry as it continues to grow.

2) Tailored compliance plans

Equity Trustees notes Treasury's comments relating to compliance plans and the apparent absence of tailoring to individual schemes. As Treasury note, incorporating other registered schemes compliance plans by reference is easier to administer and by extension brings economies of scale to a number of costs to investors including RE, administration / unit registry, custody and audit fees.

However, Equity Trustee submit that the primary reason for incorporation by reference is typically driven by common controls for the key compliance obligations. For example, a simple Australian equities MIS will typically require the same control framework to be applied to another simple Australian equities MIS. As a result, it is both appropriate and efficient to incorporate by reference in such instances.

Different controls are required where there are distinct structural, procedural or risk features within the scheme that require reflection in the compliance plan. For example, where the MIS is; an IDPS like scheme; listed on an exchange or; where it contains highly illiquid assets such as property. In these instances, a compliance plan that incorporates by reference (assuming base controls are relevant to the scheme), should be supplemented by specific controls relevant to that scheme.

[1] Equity Trustees observes a number of references are made throughout the consultation paper to the CCIV regime, generally highlighting superior aspects relative to the MIS regime. Treasury should be aware that the CCIV regime is, and will remain, insignificant relative to the MIS regime until the withholding tax impediments to CCIV's are addressed and even then may not grow given the incumbency of other regimes. Consequently, to the extent those features are desirable Treasury should make such changes to the MIS regulatory framework rather than rely on CCIV's becoming the dominant structure.

On balance Equity Trustees believes the current arrangement strikes an appropriate balance to describing the control environment and managing costs to investors. However, incorporation of explicit guidance in line with the above may aid the industry and guard against inappropriate generic incorporation by reference.

Wholesale Client Thresholds

Equity Trustees considers the wholesale / retail delineation is broadly useful within the industry and helps ensure that greater resources are deployed by both the regulator and the industry in the protection of less informed retail investors. This is clearly desirable.

Equity Trustees submit the product value test at $500k remains broadly appropriate noting this is a significant sum and suggests a reasonable degree of wealth and sophistication if the investor has a sum of that size to invest in a product.

There is merit in either increasing the net assets sum within the individual wealth test or removing the family home from the inclusion in the test. This would help to ensure that inappropriate assumptions are not made regarding the sophistication of an investor based on the growth in value of a passive asset that in all likelihood wasn't purchased exclusively for investment purposes.

Suitability of Scheme Investments

When considering the future of the investment markets in Australia it appears likely that the continued growth of the superannuation system and domination of the listed and unlisted markets by large institutional superannuation investors will continue to drive the need for product innovation for non-superannuation retail and wholesale investors. Noting this macro trend, it is undesirable to unduly restrict access for those investors to potential sources of return and risk controlling investments by unnecessarily limiting retail investor access to product.

The DDO regime has recently been introduced and establishes a consumer centric approach to product design and distribution, which is supported by a range of regulatory tools available to ASIC enabling it to take swift action, should the need arise. The DDO regime has been used by ASIC to great effect since its introduction. Given this regime is focused on providing appropriate protections to retail investors Equity Trustees do not consider there is a need for further conditions or restrictions on certain investment products when offered to retail clients.

Right to replace the responsible entity

Equity Trustees agree the barriers to the replacement of the Responsible Entity are high.

We observe that the barriers to replace the RE should necessarily be high noting that the Responsible Entity is charged with the protection of investor interests and ensuring equity between investors. There can be occasions where other vested interests (investment managers, promoters, distributors and / or major investors) may seek to replace the responsible entity in order to effect changes within a scheme that may prioritise their interests at the expense of all or a minority of investors. While the barriers are and should remain high, they should not be impossible given investors should be able to effect change in any aspect of the scheme if they are unhappy with the service provided.

In recent years the industry has experienced increased difficulties, because investment platforms (both IDPS and Superannuation) have not facilitated investors/members voting on resolutions.

Equity Trustees observe that an alternate to adjusting the voting requirements to members could be to compel investment platforms (who are all AFSL holders) to facilitate the investors right to vote. Treasury's consultation correctly observes that a number of investment platforms do not facilitate voting which prevents investors exercising their rights. This is a situation that is clearly undesirable and potentially a better solution than loosening voting requirements on replacement of the RE. It is a concerning dereliction of duties by a Superannuation trustee.

Separately, while not explicitly contemplated within the consultation paper Treasury allude at item 4.1 and in respect to winding up schemes to situations where an RE is unable to continue to perform the role. Depending on the circumstances this may result in the inability to find a replacement given an incoming RE will incur liability for the decisions of their predecessor and / or be unable to conduct adequate due diligence. Treasury may wish to consider the introduction of a mechanism where ASIC can instigate the appointment of a temporary RE in a similar fashion to APRA's ability to appoint a temporary trustee in the superannuation sector. Such a scheme would allow ASIC the freedom to take appropriate action against an RE unfettered by considerations of how an appropriate managed wind down of a scheme can be facilitated. Equity Trustees submit the ability to act in such a capacity should be a specific licence condition and / or separate licence.

Right to withdraw from a scheme

Equity Trustees observe that the current liquidity arrangements are appropriate and have largely stood the test of time through various market cycles. The 80/20 rule enables RE's flexibility to ensure equity between investors can be maintained. Tighter definition of liquid assets may present unintended consequences in the event of market dislocation or extraordinary market events render assets generally considered liquid to be illiquid for a period.

While this consultation focuses on MIS, Equity Trustees observe that the liquidity rules relating to MIS are significantly superior to those in the superannuation industry where extraordinary mismatches of assets and liabilities together with investment switching availability and 30-day significant event notices all but guarantees inequity between members. Treasury should consider as a matter of urgency the application of the MIS liquidity rules to the superannuation industry.

Regulatory cost savings and other matters

Equity Trustees observe the following matters could be addressed to improve the smooth working of the industry and avoid unnecessary costs.

- The change of RE process is complicated by the inability to articulate an effective date given ASIC's approval process can vary from 1 day to several weeks. This results in frictional and unnecessary legal costs. A simple ability to use a future date (30 days from lodgement for example) would avoid this.

- The inability to lodge compliance plans and audit files electronically to ASIC is arcane and easily addressed reducing friction and opportunity cost in the system.

- Equity Trustees believes that it may be useful and opportune to clarify a number of roles played in the value chain of the managed investment scheme. The roles and responsibilities of the RE are well articulated. However, it is often assumed the RE role and the investment management role are performed by the same (or related) entities.

This is often not the case. Further, while the role of custodians and administrators / unit registries are reasonably understood the role of promoter / distributors is less well understood or recognised. Noting the centrality of the promoter / distributor to the DDO regime it may be opportune to articulate the relative roles and expectations of other parties that are essential to the successful operation of an MIS

- Finally, Equity Trustees observe that the subject of capital is not part of the scope of this consultation, notwithstanding, it is central to consumer protection and international competitiveness. Equity Trustees submits that capital requirements are essential, however in their current form they do not support improved performance or the innovative development of the financial system. To address this shortcoming while still achieving ASIC's regulatory objectives, Treasury could consider one of the following courses of action:

    1) Introduce a cap on the NTA requirements of REs that is comparable with other international regulations

    2) Introduce a cap on the NTA requirements of REs that is above other international regulators.

    3) Recognise the role insurance plays in addressing the operational risk element of the regulatory objectives by allowing insurance cover to count as part of the NTA calculation.

    4) Amend the calculation methodology to align with the earning of revenue across the value chain (thereby attempting to align the capital holding with the source of operational risk). For example, in the case of the RE amending the calculation from 10% of the ICR to 10% of the RE's fee with the remaining capital held proportionately across the value chain.

We hope that these observations are useful in informing Treasury's considerations. If you have any queries, please do not hesitate to contact me.

Yours sincerely

Mick O'Brien

Managing Director