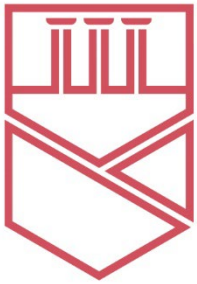

MSC TRUSTEES

REVIEW OF THE REGULATORY FRAMEWORK FOR MANAGED INVESTMENT SCHEMES

Submission
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Author Background: MSC Trustees

MSC Trustees (Melbourne Securities Corporation Ltd T/As MSC Trustees, ACN 160 326 545, AFSL 428289, ACL 428429) is a professional trustee firm active in the Australian managed investment schemes market since incorporation in 2012.

The firm is part of MSC Group, a diversified provider of fund services including corporate trust, financial intermediary and fund administration services to Australian and international fund managers and other financial service providers.

MSC Group's core businesses are active across a full range of finance and investment markets and capital structures and is one of the only businesses currently holding multiple licenses to provide services to funds in both Australia and Singapore.

MSC Trustees provides trusteeship to retail and wholesale managed investment schemes, as well as in the retail corporate debt market for notes, bonds and debentures. It currently acts as trustee for 151 managed investments schemes. Current funds under appointment across MSC Group total approximately AUD $6 billion.

Importantly, all MSC Group services are provided independently to third party fund sponsors and product managers. MSC Group never solely operates its own funds, and always seeks to preserve neutrality and independence to product sponsors and managers.

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General Comments

The Managed Investments Act was introduced in 1998 and implemented in 2000 to solve issues associated with the confusion of the roles of the Trustee and the Investment Manager in managing retail unit trusts.

The single Responsible Entity (**RE**) regime was introduced to solve this problem, with a view that ultimate responsibility for operation of a retail fund on a single entity, being the trustee of the fund.

In our view, whilst there was good intent in removing disagreement and difficulty in establishing responsibility for any harm caused in the operation of a retail fund, this legislation was shortsighted for a number of key reasons:

1) It ignored the complexity of fund operation and necessity for key expertise and resourcing in administering all aspects unlikely to be able to be provided by one party, including: investment selection & management, distribution, investor relations, financial management, fund administration, fund registry, fund accounting and audit, compliance, legal and taxation.
2) It ignored and complicated the important role of a trustee operating under trustee law and its wholly focussed primary role of member/investor protection.

3) It ignored the benefit and protection provided by a trustee acting independently of other roles in a fund structure, particularly that of the investment manager and fund promotors/distributors and thereby avoiding inherent conflict, for example, when a trustee who should be solely acting in the best interests of investors is also responsible for promotion or investment decisions which directly influence remuneration, or in a wind up situation when managers are often creditors of a fund and can't possibly also act as trustee in the best interests of investors.

4) It did not consider adequately the structure and nature of comparable fundraising vehicles in other jurisdictions around the world including in the UK and EU which are conducted with clear delineation and separation of duties between the manager of the assets and the independent trustee/depository or custodian that oversights them, recognising the importance of focus and expertise in individual areas of fund operation.

The single Responsible Entity (**RE**) regime was intended to solve this problem, but anecdotally all that happened is that for control purposes and cost reduction, Investment Managers have often preferred to become their own RE, removing protection otherwise provided with structural independence being absent in a large number of new structures.

Over the last 23 years, we believe this lack of structural independence and protection has contributed to complex products being sold to retail investors and often disconnection between the liquidity of the products and the assets in which they ultimately invest. In addition it has lead to operators acting in multiple roles that are in conflict with the obligations of each role and the expertise required to undertake each role.

This paradox has been exacerbated with the introduction of the Design & Distribution Obligations (**DDO**) and other requirements such as Tarket Market Determinations (**TMDs**), which again, with good intent are designed to increase investor protection, but for which responsibility has been allocated solely to the Trustee or Responsible Entity.

So the protection of investors is based on:

a) an imprecise categorisation of the skill of the investor (i.e. retail vs sophisticated/professional Investor); and

b) who the product is being distributed to (i.e. DDO and TMD).

In our opinion, this allocation of further responsibility to the trustee is misdirected because:

1) The Trustee is generally not the designer nor the distributor/promotor of the product.

2) It impacts the ability of the Trustee to specialise and focus on its core duty to act as trustee of the fund and dedicate resourcing to this role.

3) It increases the risk and costs of acting as trustee for a fund, reducing appetite from professional trustee companies to service retail funds, creating bottlenecks and restrictions to new products which could otherwise rely on other services providers dedicated to core functions of product design and distribution and limiting access for retail investors to participate in investment opportunities with independent trustee protection.

4) It ignores that most investors need to obtain independent advice and reduces ownership of some level of their own responsibility for investment decisions.

We consider the role and independence of professional trustee firms are critical to the industry as a key component of investor protection. We submit that a trustee/responsible entity that is independent from the Investment Manager can provide a level of oversight and expertise to ensure that the complex regulatory requirements are complied with within structures that are often complex. But we strongly feel the simplistic approach to driving all responsibility for all aspects of fund operation to a single entity is unrealistic and detracts from focus and attention to the key role of being a trustee.

In our opinion this will continue to lead to less appetite from professional trustee firms in perform the role and ever-increasing likelihood of investment managers reluctantly but also having no choice but to attempt to perform the trustee role themselves, completely removing the independent protection provided by professional and independent trusteeship.

In addition to the core responsibilities of the Trustee, focussed on investor protection, an independent trustee role contributes with expertise and regulatory compliance oversight of Managed Investment Schemes.

An ever-larger concern is the inherent conflict created when duties and responsibilities are not separated, also demonstrating a lack of understanding of complexity, expertise and resourcing required for each component of professional fund management.

Proposed Model

One possible alternative solution for consideration is to categorise both retail (registered) and wholesale (unregistered) products either as Simple or Complex, potentially defined as follows:

Simple products: A managed investment scheme with no more than 5% of individual asset class and 25% in total in the asset classes of: shorting, other derivatives (excluding FX hedging only), agricultural, property, property development, credit, illiquid assets, private equity, fund of funds and gearing. Simple products would be available to all investors. Listed or unlisted simple products could be operated by any Trustee/RE via short form offer documents (PDS/IM).

Complex products: All non-simple products. These products would only be available to sophisticated, professional and wholesale investors. These products could only be operated by qualifying professional trustee firm by long form PDS/IM.

Trustees of Simple products would still be required to meet RG166 financial requirements and carry adequate professional indemnity insurance.

However, to be a Trustee/RE of a Complex product you would additionally need the following:

a) Minimum professional indemnity insurance of AUD $15M.

b) Demonstratable separation of trustee duties from investment management and distribution covering key oversight across compliance, risk, disclosure and investor communication.

Similar to duties for CCIV corporate directorship and other international models, the Trustee/RE of a Complex product must operate with a majority independent Board of Directors.

If this model is adopted, the following associated changes would be required:

a) RE/Trustees proposing to issue complex product will need to upgrade their license and meet higher level of standards as described above on an ongoing basis.

b) DDO and TMD statements regulation can be removed.

c) PDS and IMs will need to reflect Simple short form and Complex long form, as appropriate.

d) An office of the RE and designated roles will need to be included in regulations, similar to those in the UK and EU

Separately and additionally, we need to recognise the role of product managers and sponsors for what they truly are, Fund Managers, being architects of products and recipients of the largest share of remuneration for financial product performance after investors.

It is our suggestion that references and use of terms such as Investment Managers are inadequate and unrepresentative of the true role product managers and sponsors have in fund operation. For example, they are often the principal instructing party to the Trustee/RE and they often are responsible for selection, appointment and day-to-day management of all service providers to the fund, including Trustee/RE, custodian, administrator and promoters/distributors.

In our view, the concept that the Trustee/RE is the product issuer and responsible for the design of the product can be misleading and not befitting of its role at law and under the fund constitution.

Chapter 1: Wholesale Client Thresholds

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1. **Should the financial threshold for the product value test be increased? If so, increased to what value and why?**

   Yes, recommend increase to AUD $1 million to reflect inflationary impact since original implementation.

2. **Should the financial thresholds for the net assets and/or gross income in the individual wealth test be increased? If so, increased to what value and why?**

   Yes, recommend increase to net assets of $5 million and gross income to $400K per annum.

3. **Should certain assets be excluded when determining an individual's net assets for the purposes of the individual wealth test? If so, which assets and why?**

   No.

   If consent requirements were to be introduced:

   a. **How could these be designed to ensure investors understand the consequences of being considered a wholesale client?**

By specifically indicating that protection avenues available to retail investors would not apply, including removing any uncertainty around services such as financial ombudsmen (AFCA) and other ASIC monitored protections such as DDO and TMD. Separately, it should be clear to all investors if the product is to be registered or not, with protections not available if unregistered being suitably disclosed.

b. **Should the same consent requirements be introduced for each wholesale client test (or revised in the case of the sophisticated investor test) in Chapter 7 of the Corporations Act? If not, why not?**

Yes.

Chapter 2: Suitability of Scheme Investments

4. **Should conditions be imposed on certain scheme arrangements when offered to retail clients? If so, what conditions and why?**

Only where the product does not benefit from professional trusteeship independent of the investment manager by a suitably qualified professional trustee. The role of professional trustees in our industry should be acknowledged and appreciated, especially as a potential condition and barrier to retail products with more complexity in capital structure, mandate or assets.

5. **Are any changes warranted to the procedure for scheme registration? If so, what changes and why?**

The Compliance plans still require wet signatures by all Directors and to be manually posted to ASIC. We advocate that there should be an independent Board and therefore electronic signatures should be acceptable and compliance plans should be lodged through the ASIC portal rather than posted.

6. **What grounds, if any, should ASIC be permitted to refuse to register a scheme?**
n/a

Chapter 3: Scheme Governance and the Role of the Responsible Entity

7. **Are any changes required to the obligations of responsible entities to enhance scheme governance and compliance? If so, what changes and why?**

Refer to general comments section of this submission.

8. **Should ASIC be able to direct a responsible entity to amend a scheme's constitution to meet the minimum content requirements, similar to the CCIV regime?**

No ASIC is not the product issuer.

9. **Are changes required to the compliance plan provisions to ensure compliance plans are more tailored to individual schemes? If so, what changes and why?**

   Where there is an independent trustee or RE, a master compliance plan concept should be introduced to allow standardised documentation of developed processes and controls that are applied across all Schemes that the trustee/ responsible entity is responsible for.

   Individual tailored compliance plans do not recognise the resources that independent trustees put into developing processes and controls to ensure the scheme comply with legislation.

10. **Should auditors be legislatively required to meet minimum qualitative standards when conducting compliance plan audits? If so, what should these standards be and why?**

    No they are already subject to auditor legislation and the audits are comprehensive.

11. **Should responsible entities be required to have a majority of external board members, similar to the CCIV regime?**

    Yes.

Chapter 4: Right to Replace the Responsible Entity

12. **Are any changes required to the voting requirements or meeting provisions that allow members to replace the responsible entity of a listed scheme? If so, what changes and why?**

    We believe the unitholder meeting requirement has failed as investors and IDPS platforms in particular have no compulsion to vote, thus getting sufficient numbers to change an RE is offered not achieved and a barrier to changes. Further, RE changes should be a commercial relationship like in the UK and changes can be announced to investors and if sufficient, say 10% of investors, reject the change then a unitholder meeting must be called ie make it the exception vs the rule

13. **Are any changes required to the voting requirements or meeting provisions that allow members to replace the responsible entity of an unlisted scheme? If so, what changes and why?**

    The provisions should be the same.

14. **In what circumstances should an existing responsible entity be required to assist a prospective responsible entity conduct due diligence? What might this assistance look like?**

Yes there should be a requirement to disclose any known issues including legal matters, regulatory enquiries, complaints, breaches etc. The retiring RE should also assist with any issues the arise later that originated at the time they were RE.

15. **Should there be restrictions on agreements that the responsible entity enters into or clauses in scheme constitutions that disincentivise scheme members from replacing a responsible entity? If so, what restrictions may be appropriate?**

    No But a change in RE the previous RE must still be responsible for assisting with regulatory issues that arise with the scheme in relation to matters while it was the responsible entity.

Chapter 5: Right to Withdraw from a Scheme

16. **Is the definition of liquid assets appropriate? If not, how should liquid assets be defined?**
    No comment

17. **Are any changes required to the procedure for withdrawal from a scheme? If so, what changes and why?**
    No comment

18. **Is there a potential mismatch between member expectations of being able to withdraw from a scheme and their actual rights to withdraw? If so, how might this be addressed?**
    No comment

Chapter 6: Winding Up Insolvent Schemes

19. **Are any changes required to the winding up provisions for registered schemes? If so, what changes and why?**

    No comment.

20. **Would a tailored insolvency regime for schemes improve outcomes for scheme operators, scheme members and creditors? Are there certain aspects of the existing company and CCIV insolvency regimes that should be adopted?**

    No comment.

21. **Should statutory limited liability be introduced to protect personal assets of scheme members in certain circumstances? If not, why not?**

    No comment.

Chapter 7: Commonwealth and State Regulation of Real Property Investments

22. Do issues arise for investors because of the dual jurisdictional responsibility when regulating schemes with real property? If so, how could they be addressed?

No comment.

Chapter 8: Regulatory Cost Savings

23. What opportunities are there to modernise and streamline the regulatory framework for managed investment schemes to reduce regulatory burdens without detracting from outcomes for investors?

All regulatory forms should be adopted in the ASIC portal. There should be the ability to look up and manage forms and invoices using the ARSN, similar to the company portal and the license portal.