Treasury- Review of the regulated framework for managed investment schemes

Submission from Vasco Trustees Group

September 2023

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About Vasco Trustees Group

Vasco Trustees Group (Vasco) was established in 2009 and today acts as trustee or responsible entity for over 75 retail and wholesale funds across a range of diverse asset classes. Vasco ranks amongst the 6 largest independent trustee companies in Australia.

Vasco operates through different operating companies and currently holds five Australian Financial Services Licenses and an Australian Credit Licence. In addition to trustee services Vasco provides fund administration, registry and product development services.

About the Author

Craig Dunstan is the joint founder and Managing Director of Vasco and has worked in the funds management industry for over 35 years. He has established and managed funds in Australia, Singapore and the United States.

Mr. Dunstan holds a Bachelor of Commerce and Bachelor of Laws from the University of NSW, a MBA from Hull University and a Graduate Diploma of Applied Finance & Investment from FINSIA.

Apart from his role as Managing Director of Vasco he also holds a number of other roles including:

- Chair of Futurity Investment Group, Chair of their People & Culture Committee and member of their Investment Committee (Futurity is an APRA regulated insurance company)
- Non- Executive Director of La Trobe Health and chair of their Investment Committee (Latrobe is an APRA regulated health insurer)
- Independent Director and Chair of the Investment Committee of REI Super (REI is an APRA regulated industry super fund)
- Non-Executive Director of Federated Investors Australia Services Limited (the Australian subsidiary of the global Federated Hermes financial services group).

Mr. Dunstan has also held roles with the former ASX listed MacarthurCook (a $1 billion Asia Pacific real estate investment manager he founded and acted as Managing Director and Chief Investment Officer) and Australian Unity Limited (where he was General Manager Financial Services and Chief Investment Officer and founded the $3 billion Australian Unity Healthcare Property Trust).

The views expressed in this submission are those of Vasco Trustees Group and no other party.

1. Overview

We welcome Treasury's review of the regulated framework for managed investment schemes. We are of the opinion that there are a range of measures that could be adopted that would improve outcomes for investors. In our submission we outline those suggestions.

2. List of Consultation Questions

Chapter 1- Wholesale client thresholds

1. Should the financial threshold for the product value test be increased?

   No, $500k is a substantial amount to invest in any one investment.

2. Should the financial thresholds for the net assets/and or gross income in the individual wealth test be increased?

   Our view is that better outcomes for investors are more likely to be achieved through investors becoming better educated about investment matters and as a consequence they will make better choices.

   We believe investors should educate themselves before investing, understand what they are investing in, seek appropriate advice and take responsibility for their choices. Increased regulation that provides too many safety nets for investors making poor choices will likely lead to poor outcomes.

   We are of the view that an "Accredited Investor "regime be established whereby if investors wish to invest in certain higher risk asset classes or investment strategies that they should be required to undertake a relevant course such as a RG 146 course and be accredited to invest in that asset class or investment strategy. ASIC would issue the investor with an accreditation number and when investing the investor provides proof that they are accredited.

   No dollar amount test can ensure that investors understand what they are investing in. All it can do is potentially minimize the impact of investment losses due to their other income or net assets.

   Should the thresholds be changed, we would suggest net assets of $2m excluding the primary residence and including their superannuation. The gross income amount of $250k per annum remains reasonable.

3. Should certain assets be excluded when determining an individual's net assets?

   Yes, an investors primary residence should be excluded.

4. 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? and (b) should the same consent requirements be introduced for each wholesale client test?

   Practically the Sophisticated Investor Test or acknowledgment does not currently work as the obligation is on the licensee to be reasonably satisfied that the client is able to assess the product. Our firm does not accept investors into any of the funds we administer on the basis of this test as we are in no position to assess the level of knowledge of the client. We are an independent trustee and fund administrator and not a financial planning firm or accountant. We do not know the investors in the funds, do not know their financial background and

have no basis to assess them yet the obligation legally is on us to make the assessment not on their financial planner.

If the sophisticated investor test is to continue then the acknowledgement should be provided by their financial planner not the issuer of the product.

Any initiative that involves investors having a greater understanding of the investment, its risks and the consequences of failure and puts the responsibility on the investor to make sound choices is likely to lead to better outcomes.

Chapter 2- Suitability of scheme investments

5. Should conditions be imposed on certain scheme arrangements when offered to retail clients?

   It would be reasonable for ASIC to deem certain asset classes or investment strategies to be suitable only for wholesale clients. Exceptions could be made where the investor has received financial planning advice or is an "Accredited Investor "for that asset class or investment strategy.

   Alternatively, investors could provide an acknowledgement that the investment in the high-risk asset class or strategy does not comprise more than a certain percentage of their investable assets (say 10%, with the investible assets including their gross assets, including superannuation but excluding their primary residence).

   The objective is to limit losses for retail investors from making ill-advised investments into high-risk assets and strategies that they do not understand.

   Currently we have an unsustainable situation in the industry where increasingly investors are not seeking financial planning advice, make poor decisions and then expect to be bailed out by ASIC or the Australian Financial Complaints Authority. This has led to a substantial increase in claims, substantial increases in insurance premiums, losses to insurance companies resulting in many insurers leaving the Australian market. Professional indemnity insurance has become exceptionally difficult to obtain and very expensive. Ultimately consumers will bear these costs.

   Any initiatives that reduce the potential for investor losses will assist investors and the sustainability of the industry.

6. Are any changes warranted to the procedures for scheme registration?

   No, we do not see any need to change the current registration process.

7. What grounds, if any, should ASIC be permitted to refuse to register a scheme?

   Unless the responsible entity has a "kind license" the registration of the scheme entails ASIC making an assessment of the capability of the organization to manage the particular scheme that is being registered. This entails both an assessment of the scheme documentation but more importantly as part of the AFS license variation, the capability of the organization. This process which can take up to 9 months in our experience. The current process is appropriate.

Chapter 3- Scheme governance and role of the responsible entity

8. Are any changes required to the obligations of responsible entities to enhance scheme governance and compliance?

   A distinction should be made between independent responsible entities and internal responsible entities. Corporate trustees who provide responsible entity services provide an important governance role and are

effectively pseudo regulators of the funds they are trustee or responsible entity of. The major corporate trustees such as Perpetual, EQT, One Investment Group, Melbourne Securities Corporation and Vasco act for about 2000 funds collectively and have the resources and governance and ethos to focus on the best interests of investors.

Where the trustee function is internalized the interests of investors are inherently in conflict with the commercial interests of the fund management business.

In our view outcomes to investors would be improved through making it more difficult for a start up manager to undertake the responsible entity function internally. At a minimum they should be compelled to engage an independent corporate trustee for an initial period of 3 or 4 years. This will enable them to better understand their obligations and the processes required.

At the moment it is too easy for a start up manager to receive approval to be their own responsible entity.

9. Should ASIC be able to direct a responsible entity to amend a scheme's constitution to meet minimum content requirements?

   We have no issue with this suggestion however in practice we would expect that ASIC could achieve this currently through their broad range of powers and influence.

10. Are changes required to the compliance plan provisions to ensure compliance plans are more tailored to individual schemes?

    Compliance plans in our experience are reasonable tailored to funds. That said we do not consider such plans overly material to the outcomes achieved by investors.

11. Should auditors be legislatively required to meet minimum qualitative standards when conducting compliance plan audits?

    Auditors currently are struggling gaining the resourcing to complete their current obligations with many audits not being completed on time due to lack of staff. It is uncertain as to when this issue with be resolved. Imposing additional requirements on auditors, whilst good in theory, will have some practical challenges in the near term.

12. Should responsible entities be required to have a majority of external board members?

    A board of directors of a responsible entity has dual obligations being to the investors in funds of which it is responsible entity and also to the shareholders of the company. Having a majority of external board members would assist in managing these natural competing issues.

Chapter 4- Right to replace the responsible entity

13. Are any changes required to the voting requirements or meeting provisions that allow members to replace the responsible entity of a listed scheme?

    We do not act for any listed funds and hence have no opinion on this issue.

14. Are any changes required to the voting requirements or meeting provisions that allow members to replace the responsible entity of an unlisted scheme?

    The practical reality is that members do not seek to replace responsible entities. The action to replace a responsible entity in our experience is initiated by investment managers who either wish to internalise the function or wish to move to a responsible entity that has a softer approach to compliance.

    The law places a lot of obligations on responsible entities who are entrusted to look after the interests of investors. How can they do their role if they have little authority or support from regulators and are easy to replace? Corporate trustees have the constant pressure of supervising investment managers appropriately on the one hand whilst maintaining relationships with the investment managers so they do not lose the client.

In our opinion responsible entities need more powers to do the job expected of them not less. To change the auditor of a fund requires a detailed process yet to change a responsible entity is relatively easy. We believe that there needs to be an assessment by ASIC that the change is in the best interests of investors before the change occurs. Investors are not sufficiently well informed to make sound decisions on a change of responsible entity.

15. In what circumstances should an existing responsible entity be required to assist a prospective responsible entity conduct due diligence?

    An existing responsible entity should not be required to provide assistance. A prospective responsible entity has access to the public documents of the fund being the constitution, compliance plan, annual accounts, unitholder register, product disclosure statement and any continuous disclosure notices. That should be sufficient for the purpose.

    Assisting an prospective responsible entity exposes the current responsible entity to litigation. Generally responsible entities are very wary of taking over a fund from another responsible entity.

16. 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?

    The role of responsible entity carries with it a lot of responsibilities and obligations and prospect for litigation and complaints to AFCA. Responsible entities need to be provided the support and powers to do the job that regulators and the public expect them to undertake. In reality though there is little to no support and not enough power to keep investment managers in line.

    Commercially and from a compliance perspective we are not prepared to act as trustee or responsible entity of a fund unless we are engaged for a minimum period of 4 years. This is necessary so we can invest in the resources to set up the processes to supervise the fund and so that we are in a better position to supervise the investment manager without the risk of being replaced if they don't like the compliance obligations, we place on them.

    As we discussed above practically members do not replace responsible entities. Investment managers do. Hence the need for restrictions.

Chapter 5- Right to withdraw from a scheme

17. Is the definition of liquid asset appropriate?

    Yes, practically the current definition and rules work.

18. Are any changes required to the procedure for withdrawal from a scheme?

    No, the current practices work.

19. Is there a mismatch between member expectations of being able to withdraw from a scheme and their actual rights to withdraw?

    Quality Illiquid assets such as real estate, infrastructure and private credit can be a sound investment for any diversified portfolio. All major superannuation funds have material allocations of circa 20% or more to illiquid assets.

    There is nothing in essence wrong with illiquidity. We allow the public to deposit money with banks but in reality, if all depositors wanted their money back at the same time the bank would not be able to fund it. Similarly, if all superannuation members withdrew at the same time the superannuation fund would not have the money for some time.

The issue is not the funds or assets but an acceptance by investors of the reality of the nature of the asset class.

Chapter 6- Winding up insolvent schemes

20. Are any changes required to the winding up provisions for registered schemes?

    No, current processes work.

21. Would a tailored insolvency regime for schemes improve outcomes for scheme operators, scheme members and creditors?

    Insolvency regimes have not historically served creditors well as the insolvency practitioners have a commercial incentive to keep the process running as long as possible to maximise their fees.

22. Should statutory limited liability be introduced to protect personal assets of scheme members in certain circumstances?

    We do not consider this matter to be an issue. Most constitutions have standard clauses that limit unitholder liability. Global investors are very familiar with the unit trust structure. The statement that investors in the Asia-Pacific region are accustomed to investment schemes structured as corporate vehicles is incorrect. The CCIV structure is unlikely in our view to achieve any significant traction amongst investment managers or foreign investors.

Chapter 7- Commonwealth and state regulation of real property investments

23. Do issues arise for investors because of dual jurisdictional responsibility when regulating schemes with real property?

    We have no opinion on this issue as we do not deal with the type of schemes impacted.

Chapter 8- Regulatory cost savings

24. 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 regulation should be assessed to ensure it achieves the desired outcomes so that there are learnings over time so that regulation can be modified and improved. In looking at a typical fund management business of 35 years ago you would find that there would not have been any compliance, risk management or legal staff. Now most firms have almost the same number of such staff as they have investment professionals. Are investors achieving better outcomes today than 35 years ago however? At most the question is debatable however more telling is there is no empirical evidence that it is the case.

    There also needs to be consideration of unintended consequences of well-meaning regulation that indirectly leads to poor outcomes.

    The Royal Commission of 2017 into the financial services industry led to increased requirements on the financial planning industry. As a consequence, the number of financial planners in Australia has declined from 28,000 in 2019 to 15,800 today. As a result, more investors are making investment decisions without seeking advice. This has directly increased the amount of poor investment decisions and poor outcomes for investors.

    A further consequence is the number of claims lodged with the Australian Financial Complaints Authority resulting in compensation payments. This directly leads to insurance claims and has made the writing of financial risks in Australia unprofitable for insurers. Recently global group AIG exited the Australian market and a large number of Australian license holders now need to obtain insurance from Lloyds in London. Professional indemnity insurance premiums have increased astronomically and ultimately such costs will need to be borne by investors.

Education and personal responsibility are the only long-term solutions for investors obtaining better outcomes.

Other initiatives that could help in managing costs are having a greater differentiation between wholesale and retail funds. From a compliance perspective and regulatory interaction perspective there is currently too little difference.

We also believe the industry funding model for both ASIC and AFCA is flawed as it does not ensure focus on the major issues and leads to both organisations continuing to grow without normal commercial constraints.

3. Suggestions that would lead to better outcomes for investors

In our view investor outcomes would be enhanced through the following initiatives:

- There should be an "Accredited Investor "regime for investors who wish to invest in very high-risk assets. This should entail completion of an appropriate course and registration with ASIC. Access to AFCA should be limited if normal investor losses occur.

- There needs to be greater restrictions on a company becoming a trustee of a wholesale fund or responsible entity of a retail fund. Currently it is too easy to be trustee of a fund with few resources, skill or appreciation of the role.

- Responsible entities and trustees need to be provided with greater powers and support from ASIC to fulfil their obligations. It is currently too easy for an investment manager not wanting to fulfil their compliance obligations or with a conflict to garner investor support to change a trustee or responsible manager. There needs to be a more independent assessment as to whether the change is in the best interests of investors.

- A few decades ago, the forerunner to ASIC had a trustee consultative committee where the regulator met with the major trustees and asked about what issues the industry is facing and how outcomes can be improved. In 14 years as a corporate trustee Vasco has never had engagement from a regulator seeking our views.

- The public should be encouraged to seek independent financial planning advice. The current trend of investors not seeking advice has led to poor investment decisions.

- There should be greater differentiation between the regulation of retail funds and wholesale funds.

- Access to and affordability of professional indemnity insurance is a major issue in the financial services industry.

- There should be a register of responsible managers and compliance committee members.

- Where an investment manager is operating under a corporate authorised representative agreement with a licensee and their authority is restricted those restrictions should be made publicly available. Currently the restrictions are input into the ASIC portal however investors are not aware of them.

- The use of "badges" on the cover of offer documents as to risk and liquidity profile would assist investor understanding.

- Some government entity should take responsibility for investor education. Currently the regulatory focus is more on punishing or compensating parties after an event rather than prevention and encouraging good decision making.