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# **Trustee Corporations Association of Australia**

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## **Inquiry into Financial Products and Services in Australia**

**Submission to  
Parliamentary Joint Committee on Corporations  
and Financial Services**

**July 2009**

## **Introduction**

The Trustee Corporations Association (TCA) is the peak representative body for the trustee corporations industry in Australia.

It represents 17 organisations, comprising all 8 regional Public Trustees and the great majority of the 10 private statutory trustee corporations (see Attachment).

Our members' provide a wide range of wealth management products and services to individual and corporate clients, including:

- traditional activities, such as estate planning, wills, powers of attorney, deceased estate administration, and management of charitable and other personal trusts.
- superannuation fund trustees / administrators.
- responsible entity for managed investment schemes.
- corporate activities such as debenture trusteeships, securitisation facilities, and custodial services.

We are pleased to provide comments in relation to the Committee's Inquiry into Financial Products and Services in Australia.

## **Comments**

### Regulatory environment

A useful starting point when looking at this matter is to consider the nature of the regulatory framework that applies to the financial sector.

That framework draws a distinction between two broad sectors:

- (i) the prudentially supervised area....banks, other ADIs, super, insurance.

Because.....

(ii) the remainder of the financial sector that is subject to a 'disclosure' regime.. licensing requirements.. financial advisors, fund managers...

The Committee needs to consider whether that basic distinction should remain.

We believe that an efficient financial system should maintain a risk spectrum....

If so, are current requirements adequate?

#### Licensing criteria

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#### Appropriateness of advice

what is 'reasonable basis for advice...' linked to issue of consumer understanding ...education...

New FPA 'guidelines' re 'client first'...

Often appears to be conflict of interest.... Commissions etc

#### Consumer education

It is clear that many investors in the failed property groups did not fully appreciate the risks involved.

.... important that efforts to raise the general level of financial literacy in the community continue to receive attention.

The TCA supports the Government's efforts to promote the education of the community in relation to financial matters (such as through the work of the Financial Literacy Foundation) in order to facilitate better risk assessment by investors.

... investors need to be fully informed when investing in financial products. [recent example: moves by ASIC to provide investors with

better, clearer and more consistent information in debenture disclosure documents.]

### Ratings Agencies

Scanlon:

I would like to see the TCA raise (in addition to what ever else is pertinent) the issue of ratings from ratings agencies, such as Standard and Poor's. In particular, ratings on products that result in individuals and institutions investing in inappropriate financial instruments because the rating was investment grade.

### **ASIC:**

CRA's have ASIC class order relief from Australian Financial Services licensing provisions on the basis that they comply with the 2004 International Organisation of Securities Commission (IOSCO) *Code of Conduct Fundamentals for CRA's* (IOSCO Code).

Although ratings are useful for limiting, monitoring and communicating the credit risk that investors take, they do not wholly reflect the level of liquidity, market or volatility risk of a particular security. Institutional investors have relied too heavily on credit ratings in their investment guidelines and choices. Examples include substituting ratings for independent risk assessment and due diligence, and relying exclusively on ratings for valuation.

ASIC has not relied heavily on recognition of CRA's in its regulatory policy. For example, CRA's ratings do not form part of any regulatory definitions (e.g. for cash management trusts); they are not mandatory in a prospectus for debt issues. Nor do they play a role in ASIC's financial requirements policy for AFS licensees.

However, there are two areas in which ASIC does acknowledge the role of CRAs:

- 0 (a) Class Order (07/428) *Consent to quote: Citing credit ratings, trading data and geological reports in disclosure documents and PDS* which gives relief for securities and financial product issuers to cite credit ratings in a fundraising disclosure documents without the consent of ratings agencies; and
- 1 (b) Benchmark 4 in ASIC Regulatory Guide 69 *Debentures—improving disclosure for retail investors* which outlines ASIC's expectations on issuers having their unlisted debentures rated for credit risk by a recognised credit rating agency.

The fact that ASIC requires an explanation of the rating in both of these cases is recognition of the limitations of the credit rating as a risk tool.

### **Storm**

Storm's first problem was that many of its clients were saddled with massive levels of debt - investors were frequently advised to take a bank loan out against the equity in their home, which would then be used to secure a larger and more risky margin loan.

The decision to consult with a Storm adviser typically came through personal referrals.

While many clients say they were a little sceptical of the high levels of debt Storm recommended, they were assured that investing in funds which spread the risk across the stock market - was solid enough to withstand any previous market collapse.

Finally, after their investment began to show results, they decided to place their full trust in the company and go along with whatever their adviser recommended.

In essence, it encouraged people who didn't know what they were getting into to gamble everything, including most significantly their home, on the market not having a significant downturn.

#### ASIC 2009-05

- 1 Extensive use of margin loans with loan to valuation ratios (LVRs) that just could not sustain the market downturn. A good example is Storm Financial. There, for example, margin lending was extended to a 'whole balance sheet' (i.e. against all of an investor's assets) with additional leverage against unrealised gains as the market rose.

... under our system, responsibility for flawed business models lies with management and with their Boards. It's part of the 'free enterprise' system.

The second peak (ASIC) regulates securities and investments. Let me say a little more on this second peak. Unlike intermediaries (banks and insurance companies) the policy (reflected in the Wallis Report) was that financial markets did not need prudential regulation. .... at the centre of the Wallis Report was the view that efficiency of the capital markets would be enhanced by the absence of capital backing regulation and these markets only needed disclosure and transparency and enforcement of proper market conduct for their operation (e.g. the development of the securitisation markets is a good example of the working of that policy). They did not need prudential standards.

ASIC, unlike APRA, is an oversight and enforcement body. We are not a prudential authority. Several things flow from this difference:

- 1 • Inevitably ASIC will come in after a collapse has occurred. We are there, as an oversight body, to see if the law was complied with and, as such, we will arrive 'at the scene of the accident' (i.e. after the accident to see who caused it!).
- 2 • Our powers to act ahead of time are limited. For example, we do not have power to regulate capital adequacy or to prohibit certain business models.

#### Quantum

ensure consumers can distinguish between independent investment advice and sales driven financial product sales.

