1 October 2010

Responsible Entity licensing needs review - not just financial requirements

While the release of a consultation paper on financial requirements for Responsible Entities by ASIC yesterday (September 30) is a positive step, more needs to be looked at to protect investors, Mr Harvey Kalman, head of funds management of Equity Trustees Ltd, says.

"Recent events and judicial comment highlight the need for a broad review of licensing criteria for Responsible Entities as the current approach is clearly failing many investors.

"There is increasing evidence that existing licensing criteria are now weighted too heavily in favour of fund promoters, without adequate consideration of who they are," he said.

Mr Kalman pointed to recent comments by Supreme Court of Victoria judge Justice Judd, where he said that there was irreconcilable conflict between a particular manager's duty to investors and its self interest regarding its role as Responsible Entity.

"New legislation may not necessarily be required, as the clear conflict of interest of fund managers and scheme promoters, and the inadequacies of investor protection that are increasingly apparent, can largely be corrected by strengthening licensing requirements," he said.

Mr Kalman added that the Wallis Report released in 1993, which led to the introduction of the Responsible Entity concept, was called "Other People's Money".

"However, this investor protection factor appears to have been eroded. It is not only that the Responsible Entity concept has generally evolved into something less than was envisaged at the time, it is also that collective investments now being developed and offered to investors are more complex than when the Responsible Entity concept was developed and finally introduced.

"We have seen increasing mismatches between the complexity and liquidity of managed investments, and the type of investors to whom they are promoted – for example open-ended, daily priced, direct property funds offered to retail investors.

"As Responsible Entities are a relatively new concept, they are previously untried in a crisis and have not been used elsewhere in the world. The concept clearly appears to have weaknesses that have been exposed by the financial crisis and now need to be addressed.

"While the financial strength of a Responsible Entity and the people behind the fund is important, so that there is someone left standing, and worth suing if there is inappropriate behaviour, there are other areas requiring examination that are just as critical.

"Better investor protection starts with recognition that many investment schemes are now extremely complex and that there is a need for a greater degree of separation between a fund manager and the Responsible Entity.

"Greater deterrents in the form of punishment for wrongdoing should also be considered."

He said that he believed licensing changes should be introduced that take today's needs into account to better protect investors.

"For example, we could have two levels of licensing that recognise some of the more complex products now being marketed need different levels of control and protection.

"As identified by ASIC, increased capital protection for investors, whether through capital requirements placed on internal Responsible Entities or through higher levels of insurance is also needed.

"The effect and circumstances of some of the recent collective investment collapses and the role of the Responsible Entity in funds such as the MFS Premium Income Fund and the Astarra Growth Fund, where there is speculation investors are facing losses following apparent improper use of the fund's capital, need to be considered.

"The common denominator in these cases is an internal Responsible Entity which, as Justice Judd said, can be severely conflicted."

Mr Kalman said that it is usually only during and after severe market downturn that malfeasance, incompetence or conflict of interest is discovered, and when this happens it nearly always costs investors.

"Inevitably, when it does happen and when systems fail, there are reviews and changes, so it is timely that all the issues surrounding the role of Responsible Entities are looked at before the next boom starts and before current problems are forgotten," he said.

Mr Kalman added that the Responsible Entity system can work well if there is adequate separation between the Responsible Entity and the fund manager/promoter to ensure the Responsible Entity will not fail if the promoter fails.

About Equity Trustees: *Equity Trustees is a publicly listed company that provides a range of financial services to corporate and private clients. Its businesses include funds management, private client wealth management, responsible entity appointments, and corporate and DIY superannuation.*

The company manages in excess of $4 billion across its funds management, private client and superannuation businesses and has in excess of $14 billion under responsible entity administration.

Equity Trustees employs over 150 people across its Melbourne, Sydney and Brisbane offices.

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