



CP 388: NET TANGIBLE ASSETS REQUIREMENT FOR RESPONSIBLE ENTITIES



Thank you for the opportunity to provide input to this consultation process.

Overview

Equity Trustees fully supports a review into the Net Tangible Assets (NTA) requirements for REs in light of recent scheme collapses. Major investment failures in the Australian market over the recent decades, including those involving superannuation, have primarily stemmed from failures of REs.

Those failures have typically involved REs that have not been independent by any ordinary definition, nor by substance, to the fund manager whose primary function is commercial. In addition, examination of these failures indicates that the RE function was not appropriately resourced for the roles and responsibilities an RE entails. We believe reform in this area is particularly important following the collapse of the Shield and First Guardian Master Funds. It is clear that the losses incurred was due to a critical point of failure – that is, the failure of the RE of both the schemes.

We support the underlying objectives of the NTA requirement being to:

- a) Ensure the RE has adequate financial resources to meet operating costs (including costs of compliance with the Corporations Act)
- b) Align the REs interests with the interests of scheme members, by ensuring it is an entity of substance and shareholders have sufficient equity in the business to ensure success
- c) Provide some level of assurance that, if the RE fails, there is sufficient money for the orderly transition to a new responsible entity or to wind up each scheme, and
- d) Impose a liquidity component to ensure that a RE can call on its NTA to help it meet any immediate and unexpected expenses

We also agree that the financial requirements for REs should not be designed to address market or credit risks, to prevent entities from becoming insolvent or failing or for compensating clients for unexpected losses.

Accordingly, our submission strongly supports enhancements to NTA requirements for REs and we believe that the way forward includes:

- Concessional capital to be greater of:
 - Minimum capital \$2 million
 - 0.5% of FUM, or
 - 10% of RE revenue.
- Maximum capital for all RE's to be:
 - \$20 million, which is equivalent to typical global standards.
 - If \$20 million is not acceptable to the Government, Treasury or ASIC, then an alternative overall maximum capital should be \$150,000 per registered scheme.
- Retaining current liquidity requirements.
- A 12-month transition period.



About Equity Trustees

Equity Trustees (EQT Holdings Limited) was established as an independent trustee and executor company in 1888. EQT Holdings Limited is the ASX listed holding company of the group. EQT Holdings Limited owns and operates six licensed trustee entities comprising two Responsible Entities (REs), two Registrable Superannuation Entity Licensees (RSEs) and two traditional trustee entities.

Equity Trustees is now Australia's leading specialist trustee company. We offer a unique vantage point within the financial services system in our role as trustee supervising ~\$283bn of assets in thousands of trusts, managed investment schemes (MISs) and superannuation funds. We help private individuals and families, fund managers and other corporate and superannuation clients grow, manage and protect wealth.

We welcome the opportunity to provide input into consumer protections in the financial services sector. Our company was established to help people take care of their future, and we see this Review as aligned to our purpose.

The group provides RE services through its Corporate and Superannuation Trustee Services business unit. Through two subsidiary companies, the group has on issue some 430 MISs, acting as RE for 260 registered managed investment schemes and trustee for 170 unregistered schemes with \$130bn funds under management.

Provision of RE services is provided by a team of 85 professionals who specialise in fund governance – expertise not matched by any other provider in Australia. The team includes investment professionals, lawyers, risk managers, compliance officers, operational specialists, finance specialists, product specialists and disclosure experts.

Equity Trustees provides registered and unregistered MISs, retail debenture bonds, master/feeder structures, listed structures (open and closed end), dual sleeve listed/unlisted schemes, active and index strategies and all domestic and global asset classes.

We have grown and evolved the provision of RE services in the Australian market since 1998, when the Corporations Act was materially reconfigured to establish the current legislative framework for MISs and REs. Since then, many fund managers have utilised the option of an independent outsourced RE over an “in-house” RE which is integrated with the fund manager. Typically, they choose this option because it is less costly, more efficient and allows them to focus on meeting the investment objective of the MIS.

Over the last 28 years developing our capability and expertise under the current legislative framework, Equity Trustees has been an integral - and critical – part of fostering efficiency and innovation in the Australian funds management industry. The specialist independent RE model has efficiently facilitated the entry of capable leading global fund managers to the Australian market to provide world class funds management offerings to Australian consumers. The model has also enabled the efficient establishment of new Australian fund managers.

We hope that these observations are productive in informing ASICs considerations to enhance the NTA requirements of REs in the future and welcome consultation with ASIC on the detail of this submission, or any other aspect of MIS and RE reform.

Sincerely,

Mick O'Brien
Managing Director
EQT Holdings Limited



Proposal B - Options for Increasing the NTA Requirement for RE's

Proposal B1: Option 1 – Increase in line with CPI

- Q1 Equity Trustees supports in principle the increase of the financial thresholds for NTA requirements of RE's. However, we do not support the use of an accumulated CPI increase to existing minimum limits as we believe these amounts are not sufficient to achieve ASICs objectives of RE's having adequate financial resources or ensuring the RE is an entity of substance.
- Q2 We believe that the application of a one off, or ongoing, CPI increase overcomplicates the calculation. Setting an explicit minimum NTA level that reflects the financial resources required by an RE to meet operating costs and provide for an orderly transition or wind up meets the purpose of having an NTA requirement and, if set correctly, will remain appropriate for many years.
- Q3 Equity Trustees proposes a set minimum \$2 million NTA for concessional REs along with additional capital which is FUM or revenue based (up to a cap of \$20 million). This is more appropriate and easier to administer.
- In summary, we support:
- (a) Concessional capital to be the greater of:
- Minimum capital \$2 million,
 - 0.5% of FUM, or
 - 10% of RE revenue.
- (b) \$20 million maximum capital for all RE's which is equivalent to typical global standards. If \$20 million is not acceptable to the Government, Treasury or ASIC, then alternative overall maximum capital should be \$150,000 per scheme.
- Additional explanation for this option is outlined in our response to B2Q1.**
- Q4 A CPI based change will not change the level of capital Equity Trustees holds. The change will not result in increased fees to scheme members. These changes produce a marginal increase in capital and therefore capital servicing cost.
- Q5 Equity Trustees does not support the CPI indexation option and believe simpler options should be pursued.
- Q6 We do not believe increasing minimum NTA would have significant impact on competition.
- It should be recognised that most REs on the minimum are likely to be 'in-house' or integrated with the fund manager. This means they are receiving revenue for the provision of the RE service and asset management services, making the additional capital servicing cost less material proportionally.
- There may be some change required for smaller RE's, however the market currently comprises many scaled and competent independent RE providers who may be less impacted (Equity Trustees, Perpetual Trustees, One Investment Group, MSC Group, Evolution Trustees, Bennelong Funds Management, Polar 933, K2 Asset Management and Channel Capital).
- Q7 The additional benefit of increased capital from annual indexation does not outweigh the additional complexity.



Proposal B2 - Option 2 – Increase the \$150,000 minimum under the concessional NTA requirement

Q1 Equity Trustees strongly supports the increase of the minimum financial thresholds for NTA requirements of REs as capital requirements are essential. However, in their current form they do not support improved performance or the safe development of the financial system.

In addition to the Singapore and United Kingdom examples outlined in the ASIC consultation paper, it is useful to consider the Irish and Luxembourg UCITS Management Companies capital requirements. They each have a higher capital requirement which escalate in line with assets under supervision. Most other jurisdictions also have a cap on capital.

To address this shortcoming while still achieving ASIC's regulatory objectives, we strongly suggest that a minimum \$2 million NTA is set for concessional REs along with additional capital which is FUM or revenue based (up to a cap of \$20 million).

In summary, we support:

(a) Concessional capital to the greater of:

- Minimum capital \$2 million,
- 0.5% of FUM, or
- 10% of RE revenue.

(b) \$20 million maximum capital for all RE's which is equivalent to typical global standards. If \$20 million is not acceptable to the Government, Treasury or ASIC, then alternative overall maximum capital should be \$150,000 per registered scheme.

Central to this proposal is that a key reason for REs holding capital is to affect an orderly closure and wind down of the RE where that is necessary.

The closure of an RE, requires that a solution be found for each MIS the RE has responsibility for. This can mean either each MIS is closed, or an alternative RE is appointed. It should be noted that the process of closing MIS's can be long and drawn out, particularly, as is often the case, if illiquid assets are involved. Extending the time period is often in the interests of investors in order to protect the value of their investment. The closure of a listed scheme can also be an extended exercise in order to meet the stock exchange delisting requirements. The process of appointing an alternative RE can also be long and requires the step of ensuring there is approval of unitholders.

Whichever path is followed, specialised resource is required to be maintained at the RE and those resources are likely to include investment personnel, legal counsel, operational capability, product management and material external advice and support to effect a complete MIS closure. The wind up process is also often done at times of stress and therefore extra governance, and investment management experience, is often called for. Accordingly, our view is that a \$2 million minimum has the best prospect of ensuring the central purpose of the RE - to protect investors in such circumstances – is maintained.



Q2 Our preferred option is outlined in B2Q1.

Q3 If a fixed dollar is adopted, we strongly recommend a minimum of at least \$2 million in NTA. As mentioned, Equity Trustees has substantial experience with scheme wind downs, and \$2 million is adequate to wind up a number of MISs or have unit holder meetings to transfer the scheme to another RE.

Additionally, a \$2 million minimum NTA is commensurate with the responsibility and accountability of the role of RE and a higher minimum capital requirement would result in higher quality, more committed REs of substance.

The Shield Master Fund and First Guardian Funds were both applying concessional NTA requirements and operating presumably on the asset level calculation as they were above the minimum \$150,000. Equity Trustees suggests that if the minimum NTA was applied consistently across all REs and this amount was higher, the schemes may never have been established.

Q4 Our preferred option is outlined in B2Q1.

Q5 The overall cap on capital would reduce the capital held by Equity Trustees.

The change is unlikely to result in increased fees to scheme members.

Increased minimum capital requirements will increase costs to the RE and/or the investment manager. The servicing cost of the capital may be passed through to the investor as an increased price; however this is unlikely given the competitive landscape of the funds management market.

We suggest that this potential cost impact would be a reasonable trade-off for increased capital and ensuring entities of substance operate in the industry. Assuming the proposed \$1m minimum, the additional servicing cost for an RE on the minimum capital is only of the order of approximately \$60k, or \$130k for the \$2m minimum Equity Trustees proposes.

Q6 See B1 Q6

Q7 Equity Trustees does not see any material practical difficulties with this approach.



Proposal B3 - Option 3 – Increase the \$5 million cap under the concessional NTA requirement

Q1 Equity Trustees strongly supports the retention of a NTA cap. However, we suggest that this should apply consistently to all REs operating schemes rather than having differing minimum amounts for concessional and non-concessional REs and only applying the cap on one arm of the NTA requirement.

We also agree that the existing 0.5% of the average value of fund assets; or 10% of average revenue is an appropriate calculation method.

Q2 We believe that a cap should apply on the overall capital required rather than to just one aspect of the NTA calculation, that on its own has narrow application. We propose alignment with international jurisdictions by removing the \$5 million cap on the FUM arm of the calculation and replacing with an overall cap of \$20 million for all REs.

Separately, the absence of a cap for non-concessional REs can result in unnecessarily large capital requirements for larger scale REs, well in excess of international caps. This can restrict continued investment in innovation which can support a robust financial system and protect investor outcomes.

Requiring REs to hold more than \$20 million is excessive and goes beyond the objectives of the NTA requirement, as \$20 million is more than sufficient to ensure:

1. There are adequate financial resources to meet operating costs
2. The RE is an entity of substance
3. There is sufficient money for the orderly transition to a new RE or to wind up a scheme, and
4. The RE can meet any immediate and unexpected expenses.

Q3 Our preferred cap is outlined in Q1 and 2.

Q4 This change to concessional capital caps will not change the level of capital Equity Trustees holds.

The change will not result in increased fees to scheme members.

Increased minimum capital requirements will increase costs to the RE and/or the investment manager. The servicing cost of the capital may be passed through to the investor as an increased price. We suggest that this potential cost impact would be a small reasonable trade-off for increased capital and ensuring entities of substance operate in the industry.

Q5 This change will have little impact on competition given its narrow application.

Q6 Equity Trustees does not see any significant practical difficulties with this approach.



Proposal B4 - Appropriateness of the Liquidity Component

Equity Trustees supports retaining the existing liquidity requirements for REs. In order to achieve ASIC's underlying objectives for the NTA requirement we strongly support all REs holding:

- At least 50% of their NTA requirement in cash or cash equivalents, and
- 100% of their NTA requirement in liquid assets.

Equity Trustees believes the cash and cash equivalents and liquid assets requirements imposed on REs remains appropriate, even with an increase in the \$150,000 minimum NTA requirement.

The liquidity element is essential to enable the underlying objectives of:

- ensuring the RE has adequate financial resources to meet operating costs
- ensuring the RE is an entity of substance and shareholders have sufficient equity in the business to ensure success;
- providing ready access to funds (that are able to be reliably valued) if the RE fails.

Proposal B5 - Transition Period to Help REs Comply With Any Increased Requirement

Equity Trustees agrees a transition period should be provided.

We suggest that a 12-month transition period is more appropriate than 6 months to allow entities to comply with increased NTA requirements. The existing NTA has been in place for more than a decade and REs should be provided sufficient time to adjust their capital levels and review their fee structures to reflect the additional cost of increased NTA requirements.

Proposal B6 - Alternative Approaches to increasing the NTA

As outlined, Equity Trustees supports:

(a) Concessional capital to the greater of:

- Minimum capital \$2 million,
- 0.5% of FUM, or
- 10% of RE revenue.

(b) \$20 million maximum capital for all RE's which is equivalent to typical global standards. If \$20 million is not acceptable to the Government, Treasury or ASIC, then alternative overall maximum capital should be \$150,000 per registered scheme.



Proposal C - Appropriateness of the Concessional NTA Requirement for REs

Q1. Equity Trustees believes the current concessional NTA requirements is appropriate.

Q2. We do not propose any change.

Proposal D - NTA Requirements for Other AFS Licensees

Equity Trustees agrees that the NTA requirements should also apply to IDPS and corporate directors of retail CCIV's. Consistency in capital requirements across these licensees supports a level playing field across financial service providers.

We do not have other specific comments to add other in respect of D2Q1, where we do not believe there is a need to review the NTA requirement for custodial service providers.

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