Perpetual Limited

Financial Services and Credit Reform

Submission to The Treasury, Australian Government

June 2008

Introduction

Perpetual Limited (Perpetual) welcomes the reforms outlined in the Green Paper. Of particular interest to the Private Wealth Division of Perpetual are the reforms concerning Trustee Corporations and Margin Lending.

The implementation of the reforms should reduce compliance costs by eliminating duplication, and uncertainty both for clients/beneficiaries and the financial services providers. There should be positive impacts on competition although with some qualifications.

Trustee Corporations

A. Background

Perpetual's "traditional activities" (as defined in the Green Paper) are conducted by Perpetual Private Clients (PPC) as part of a specialist financial services business providing holistic financial solutions to high net worth and emerging high net worth individuals. As at 30 June 2007, these "traditional activities" contributed 38% to the annual revenue of PPC which in turn contributed 18% to the overall revenue of Perpetual.

Perpetual considers these activities to be an integral part of its overall diversified portfolio of services and products offered to the Australian public.

PPC currently conducts these activities in all main land states and territories, except the Northern Territory, through offices located in Sydney, Melbourne, Brisbane, Perth, Canberra and Adelaide. This involves eight authorized trustee corporations operating under six different state Trustee Companies Acts. This adds significantly to management, administration and compliance costs to operate nationally.

Aspects of the financial services business conducted by PPC are regulated under the Financial Services Reform regime of the Corporation Act 2001. Perpetual Trustee Company Limited (PTCo) is the holder of an Australian Financial Service License as well as being an authorized trustee under the New South Wales Trustee Companies Act. The other state based Perpetual authorised trustee companies are currently authorised representatives of PTCo. This involves regulation at the activity level rather than the entity level.

The "traditional activities" are not regulated under the FSR regime. They are currently regulated at the individual state and territory level with varying degrees of supervision, reporting and interest. Perpetual, therefore, has to manage and administer a duality system when providing a full suite of services to its clients. This adds significantly to management, administration and compliance costs to operate nationally and results in inconsistent beneficiary experience.

The majority of the other activities undertaken by Perpetual are also regulated by Commonwealth legislation. Therefore Commonwealth regulation of trustee corporations at an activity level would enable Perpetual to streamline its processes which would reduce management, administration and compliance costs and the overall cost to the end consumer of these services. This would enable Perpetual to provide a consistent service to all it clients across Australia that would be fair and equitable.

B. Current position

Perpetual agrees that the existing regulatory framework for trustee corporations provides an unnecessary burden associated with the inconsistencies in the regulatory requirements and the multiplicity of licensing and reporting requirements across all the state and territory jurisdictions. The process of becoming an authorised trustee corporation, for example, varies markedly from state to state. A trustee corporation authorised in one state, cannot, as a matter of course, operate in another state.

C. Competition

A single licensing regime will remove barriers to entry for existing trustee corporations to operate nationally and will provide a nationally competitive marketplace for the "traditional activities". However it is important that there are appropriate requirements for entry in regard to providing the "traditional activities". These services are often delivered to society's most vulnerable people and may be integral to their personal and financial health and well-being. Consequently, the provision of these services by a trustee corporation requires the highest level of corporate ethics together with significant capital expenditure in resources across expert and experienced staff, management, administration and reporting systems and risk, legal and compliance frameworks.

There are other competitors in the marketplace such as lawyers and, to a lesser extent, accountants. However these are distinguished from trustee corporations in that they are only able to provide some aspects of the "traditional activities" and must outsource others. Trustee corporations can generally provide the full range of services to cover all aspects of these activities from asset custodial services, full and detailed asset administration, investment management, comprehensive reporting, legal services, and tax and accounting services.

Further, in respect of competition, the impact of state and territories' public trustees being excluded from a national regulatory environment needs to be taken into account. These bodies provide similar services to the "traditional activities" of trustee corporations and, in some states in particular, they are direct competitors to the trustee corporations whilst having a competitive advantage through legislation – for example, having a right of appearance at guardianship tribunal hearings involving a competitor trustee corporation, or being appointed the examiner/auditor of that trustee corporation's statements of account. This does not provide for competitive neutrality. Any Commonwealth legislation regulating trustee corporations needs to incorporate the National Competition Principles Agreement to guarantee a "level playing field" for both private and public sector corporations operating in the area of the "traditional activities".

D. Commonwealth regulation options

Perpetual agrees with the main policy objectives for a Commonwealth regulatory framework. The main focus of those objectives needs to be the long term interests of the "consumers" of the services provided by trustee corporations, namely:

- individuals during their lifetime through comprehensive estate planning;
- individuals appointing trustee corporations as executors of their wills;
- individuals appointing trustee corporations as attorneys under enduring powers of attorney;
- individuals who lose the ability to manage their own financial affairs during their lifetime due to a natural or acquired brain deficiency;
- individuals named as executors or attorneys who may not be in a position to take up their appointment;
- individuals who wish to give expression to their philanthropic intent during their lifetime by establishing charitable foundations, prescribed private funds or charitable gift funds;
- individuals who wish to give expression to their philanthropic intent after their death by providing for charitable testamentary trusts in their wills;
- individuals who wish to provide for their family during their lifetime and upon their death by the establishment of discretionary and hybrid family trusts, protective trusts, disability trusts and testamentary trusts;
- the various classes of beneficiaries of estates and trusts;
- the charitable, not for profit and deductible gift recipient beneficiaries of all forms of philanthropic foundations.

E. Consumer protection supervision

Ensuring these long term interests are met would be best achieved by supervision at the level of the activity conducted by the trustee corporation (ie, focusing on the capacity and resources of the entity to effectively manage trust assets for beneficiaries) as proposed by the consumer protection option implemented by ASIC through the Corporations Act 2001. This is as opposed to prudential regulation which focuses on the capital adequacy requirements directed at the health of the corporation itself.

The disclosure obligations, licensing and ongoing oversight, and mechanism for the consumers to address issues of underperformance can be based on the structure under the existing AFSL regime. From a Perpetual perspective, the implementation and ongoing administration of such a structure would be relatively cost effective and more easily deliverable for the benefit of the consumers by leveraging from and extending the framework of the current AFS licensing regime.

There is only one point requiring clarification with the ASIC proposal – the concepts of "performance" and "underperformance". Perpetual presumes these apply at the level of the individual trust, estate or administration and relate to the ability of the trustee corporation to act in the best interests of the all of the beneficiaries, including the investment performance of the assets from both a capital and an income perspective. Perpetual presumes that "performance" does not relate to the performance of the trustee

corporation itself as to return on capital and to shareholders. The assets of all trusts do not form part of the balance sheet of trustee corporations and are protected from claims against the corporation itself. It goes without saying that a trustee corporation which does not continue to perform adequately in its own right would not continue to operate. It would be subject to take over from a licensed competitor or at the very least would have to divest itself of its trust and estate assets to an appropriately licensed competitor.

As mentioned, the "traditional activities" are often provided to the most vulnerable of people and are integral to their personal and financial health and well-being and that of their families. These people are totally dependant on the integrity and continuity of the provider of the activities. Perpetual has been doing this for 120 years and has done so on a conservative, non speculative basis over generations of families. To do this requires sufficient capital adequacy to support such long term provision of services. The current requirements concerning borrowing, capital reduction and shareholding which apply to trustee corporations differ across the states and can be very restrictive. They do not have any meaningful connection to the provision of services to consumers. The focus of capital adequacy should be on the capacity and resources of the entity to effectively manage trust assets for beneficiaries over the long term.

F. Prudential regulation

Perpetual considers that the prudential regulation option implemented by APRA is not appropriate for the regulatory supervision of trustee corporations. As the Green Paper suggests, prudential regulation is a more intense oversight of the regulated entity than a consumer protection regime, and is more prescriptive and intrusive. It is aimed at the health of the entity itself and does not focus on the capacity and resources to manage the trust assets for the benefit of the consumers referred to previously. It would be possible to have a prudentially sound trustee corporation in operation but which was still delivering poor results to beneficiaries who would be left without a mechanism to address that underperformance.

The capacity and resources to manage the "traditional activities" of a trustee corporation are not the same as, but are complementary to, those required to ensure sound prudential management of that corporation's own affairs. These activities require specialist and expert skills to manage the myriad pieces of state and territory legislation that impacts on the activities. These include the intricacies of trust law with its important focus on the distinction between capital and income, the prudent person regime, the specific investment issues that relate to these, the complexity of estate administration laws and the effect of family provision and superannuation legislation. These issues are better regulated through consumer protection supervision that focuses on organizational capability and competencies and the setting of standards to measure the delivery of service that is in the best interests of the consumer.

G. Other matters

The Green Paper is very high level. There are a number of practical matters which need to be considered. All of these arise out of the form and content the particular legislation will take. Perpetual submits that the Western Australian Trustee Companies Act 1987 provides the best example of appropriate contemporary legislation.

The matters for consideration are:

- Trustee corporations should not be required to provide sureties when taking up appointments such as administrator, trusteeships for sale and other statutory or court appointments.
- Trustee corporations should have sole standing to apply for and be appointed as administrator, trusteeships for sale and other statutory or court appointments.
- The fees that trustee corporations can charge should be deregulated and should not be subject to any statutory caps. The fees should be as approved by the Board of Directors and advertised from time to time. There has been a general but inconsistent move to annual long term fees based on a smaller percentage of the gross value of the trust assets as opposed to the traditional, but archaic, large up front capital commission and income commission during the term of the administration. A deregulated fee structure provides for greater competition as to fees and market forces will dictate what an appropriate level is.

  There needs to be the ability for the fees to be agreed by the trustee corporation with "interested parties", a concept which needs to be defined as effectively as possible.

  There needs to the ability for historical fees to be reviewed "from time to time" to bring those fees into line with current community and commercial practice with appropriate notice being given to affected parties. This can be achieved by the advertised fee regime.

  There needs to be clarification of the various descriptions of "fees" such as "commission", "management fees", "remuneration", "charges", etc. These need to be distinguished from "expenses" or "out of pocket expenses" which in turn need to be fully defined.

  Consideration should be given to trustee corporations being able to "unbundle" their fees to distinguish between the various services that the corporation provides such as basic trustee administration, custody services, investment management services, specialist services such as property management, etc.

  Fees for philanthropic trust structures should likewise be deregulated and not subject to any statutory caps. These trusts are generally established in perpetuity with the accepted philosophy of providing for long tern capital growth which in turn leads to long term growth of income to provide a more secure annuity income flow for the charitable beneficiaries into the future.

  There is also a need to allow trustee corporations to charge a fee where they are acting as an executor of a deceased estate and in their capacity as legal personal representative they must take on the role of trustee of a superannuation fund where the deceased, or a private corporation of which the deceased was the sole director, was the trustee. Quite often the assets of the superannuation fund do not form part of the estate and therefore the executor cannot charge a fee on those assets as part of the estate administration process. However the responsibility on the trustee in this situation equates to that of the executor. With the increasing focus on superannuation, and in particular self managed superannuation funds, this will become more frequent. The management of these funds is complex requiring specialist skills, and also time consuming requiring sufficient resources. Trustee Corporations are well suited to provide the skills and resources to administer the funds in the best interests of the beneficiaries and to give effect to the wishes of the deceased person.
- The operation of Common Funds needs to be confirmed. The relationship between these funds and managed investment schemes needs to be clarified.

Should Common Funds be open to investment from retail investors or should they be restricted to the investment of trust funds only. If the latter were the case there needs to be some flexibility to allow a beneficiary who receives an interest in funds or assets held in a Common Fund to be able to retain that investment in their own right without being forced to make an automatic redemption. There also needs to be consistency of fees charged between comparable funds in both environments.

- Trustee corporations should be able to invest in their own or related party products or services if those products or services are competitive with external providers and investment in them is in the best interest of the consumers. This needs to be acknowledged as not amounting to a conflict of interest. As the Green Paper recognizes, the bulk of trustee corporations' business is in the field of investment products and advice. They need to be competitive in this marketplace and should be able to leverage off their expertise for the benefit of their own consumers.
- There needs to be adequate transitional and grandfathering provisions to cover, for example, the ability for a national licensed trustee corporation to succeed existing state authorised trustee corporations within the same corporate structure in existing or future roles.
- The dispute resolution process should mirror the current FSR regime with the qualification that the external provider should be sufficiently resourced with the appropriately qualified staff to understand the "traditional activities" conducted by the trustee corporations.

H. Conclusion

Perpetual supports the reforms outlined in the Green Paper concerning the provision of a single national regulatory regime for trustee corporations. The regulation should be aimed to provide protection for the consumers of the "traditional activities" of trustee corporations in addition to the supervision of the health of the corporations themselves. Both of these objectives can be achieved by focusing on the capacity and resources to effectively manage trust assets for beneficiaries. On this basis Perpetual advocates the introduction of the consumer protection supervision model implemented and maintained by ASIC.

Margin Lending

Perpetual never short sells the shares held in custody or in trust for its clients or uses these funds in any way for its own benefit. More specifically, where people are beneficiaries of a trust, or have appointed Perpetual as trustee of some other continuing trust such as a Prescribed Private Fund, in New South Wales, PTCo is the trustee of this trust and PTCo does not use a separate custodian for our trust assets. If it is a trust with a different state based trustee company (for example Perpetual Trustees Victoria Limited), we do use PTCo as the custodian.

The money held in trust is held separately to the assets of Perpetual (the corporate entity) or those assets of any other client or trust. We would never use these assets as security for any other purposes except:

- in accordance with the terms of the trust deed: and
- for the benefit of the specific trust in question; and
- in agreement with any co-trustee of the trust.

If we were to use the assets of a trust for any other purposes this would be a very clear breach of our fiduciary obligations as trustee of the trust. There is a wealth of trust law as well as the Trustee Companies Acts and other regulations and professional standards and ethics that we would breach if we were to deal with the assets in a margin lending arrangement. This is not how Perpetual does business.

This is the same for the Small APRA Fund trustee service. If the money is held in trust on behalf of the members of the superannuation fund this would be a very clear breach of our fiduciary obligations as trustee of the trust if we used these funds in any way. There are specific rules in the Superannuation Industry Supervision Act that prevent us taking a charge of the assets of a superannuation fund. There are also specific restrictions in the trust deed that ensure that we comply with superannuation law including not taking a charge over the assets of the Fund.

In the case of the Portfolio Administration Service, which is a regulated Investor Directed Portfolio Service, in addition to our contractual obligations with our clients, we have an obligation under the relevant ASIC Class Order (which tracks back to our role as bare trustee among other things) to hold those assets separately to the assets of the company. This would mean that we cannot use those assets for the personal use or gain of the company.