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Submission to Cooper Review of Superannuation

Dear Sirs,

I wish to make the attached submission to the current government review of the superannuation system. I apologize that this submission is being made outside the Commission's stated timetable as most of the issues regard governance – for which submissions closed last year.

It was not my plan to make a submission at all. I had not heard of the Cooper Review at all until I had an informal chat with Dr Henry at the Treasury in early January 2010. I raised several issues regarding asset security in the superannuation system and he suggested that I put those in a submission to the Cooper Review. [My response was to ask what the Cooper Review was.]

A copy of this submission has been provided to Dr Henry.

I thank you for your consideration.

John Hempton
17 February 2010

Asset security – do the assets even exist? Failures in the Australian regulatory environment and how they impact on superannuation

Bronte Capital believes that there are several critical shortcomings in Australian regulation which could lead to catastrophic failure of several superannuation funds. These are funds which will be left with essentially <u>no assets</u> in exchange for a lifetime of compulsory contribution – not through investment losses but by the assets somehow disappearing through fraud and misadventure.

Ponzi frauds for example are a substantial risk to Australian superannuation. What eventually breaks all Ponzi frauds is withdrawals. Withdrawals can be paid so long as more money is flowing in than flowing out. Most Ponzis last only a few months to a couple of years because outflows become real and many people get in the habit of withdrawing (faked) interest. The longest lasting and biggest Ponzi ever exposed is Madoff – and that too broke down when withdrawals became too large. Superannuation however risks very large and long-lasting Ponzis because withdrawal is legally restricted. *The natural short life-span of Ponzis is extended by withdrawal restrictions*. It is our guess that in the absence of regulatory change and relative to GDP – Australia will wind up having the biggest Ponzi schemes ever exposed anywhere in the world. It is likely that there will be multiple such discoveries and they will be valued in the tens of billions of dollars each. However discovery of these frauds will be delayed until at least 2020 because they will rely on the baby-boomers getting old enough to make large superannuation withdrawals.

Asset disappearances in Australia

Australia has had two recent high profile instances where substantial assets simply disappeared (at least from the perspective of the holder). These two are quite different.

The first was Opes Prime – where the assets were in the custody of a stock-broker who pledged the assets for their own funding. This impacted several self-managed superannuation funds. The first part of our submission covers broker regulation in Australia and shows how it is inadequate compared to the United States. We demonstrate risks to the Australian superannuation system from inadequate broker regulation.

The second is Astarra Asset Management/Trio – and in particular the Astarra Strategic Fund. In that case the assets claimed by a fund (the Strategic Fund) simply (as of the date of writing) can not be found. This impacted several Astarra/Trio superannuation funds – with maybe 10 thousand members. The second part of our submission covers how appropriate custody arrangements look and how local shortcomings pose substantial risks to superannuation.

Why is Bronte making a submission?

There are several reasons why Bronte is making a submission to the Cooper review.

First and foremost we are qualified to do so on these issues.

John Hempton – the Chief Investment Officer of Bronte – has some expertise in broker-dealer regulation globally. As a fund manager we (collectively) have thought considerably about broker and custodian security.

Further John was the whistle-blower who exposed the Astarra problems. The scale of this issue will become clear as the matter plays out in the courts, however as it is one of the largest live cases that ASIC has ever dealt with we suggest that ASIC give the review a private summary of the case. (A public summary raises too many legal issues.)

Finally (as stated above) John was asked to write a submission to detail his concerns in conversation with Dr Ken Henry at the Treasury.

We will make ourselves available to further elucidate our concerns with panel members if requested.

Acknowledgments

We would like to thank ASIC staff for their assistance with this submission. The views however remain Bronte's alone.

Broker Dealer regulation: Australia versus the US and why Australia is deficient

First let us start with a history of US Broker Dealer regulation. This is quick – but accurate enough.

At the end of the Great Depression the US was very scared of mixing broker dealers (and investment banks) with conventional banks. The reasons were many fold – but one was hocking client assets to fund conventional banking business.

There is a substantial risk to the system in that. If the bank finances itself by borrowing on margin against client (or for that matter its own) investment securities then the bank will wind up very short of funds in the event of a sharp market decline.[1] That is a risk to the liquidity of the bank. Loss of bank liquidity in turn would cause the bank to collapse or (at a minimum) sharply restrict lending to the "real economy".

The response to this was to strictly ring fence broker-dealers and investment banks from trading banks. Two pieces of legislation were enacted. These were Glass Steagall and the 1934 Securities Act.

Glass Steagall (now abolished) restricted trading banks from owning investment banks. The 1934 Act ring-fenced broker dealers from all other businesses. The combined Acts were probably over-kill in that you had double-separation. However it is worth explaining what the 1934 Act did.

The core of the 1934 Act

The 1934 Act does many things – including restricting leverage on margin and other things. However for the purposes of our analysis the core thing it did was ring-fence the broker-dealer from all other business of the investment bank (the broker-dealer has its own capital) and sharply restrict the broker dealer from pledging or disposing of client assets.

The capital requirements of broker dealers are horrendously complicated (too complex to enforce I fear). However this is not the core aspect of the legislation. The core aspect is the restriction of pledging client assets.

In the Opes Prime case if a client took $1 million in securities to Opes Prime as collateral for a $100 thousand loan then – when Opes collapsed – the client became an unsecured creditor of Opes for the whole $1 million.

This would not happen in the US. The US restricts the amount that the client can pledge to 140 percent of the amount borrowed. The remaining securities have to sit in a "segregated client account". If the client took $1 million to the broker dealer and borrowed $100 thousand then the broker dealer could repledge $140 thousand of the client assets but the other $860 thousand would need to sit in a segregated client account. If the broker fails the

[1] The reason is obvious enough. Loans against investment securities usually involve margin. As markets go down the borrower (in this case a bank) will face margin calls draining them of liquidity.

client would immediately get back the $860 thousand and would risk only losing $40 thousand – the excess pledged over money borrowed.

More importantly the 1934 Act vastly restricts what the broker dealer can do. Of utmost importance is that it can only borrow to fund client business not broker business. In other words all borrowing of a US broker dealer is used to fund client margin loans and not (say) fund commercial property loans made by the broker dealer.

You cannot contract out of the 1934 Act. All US broker-dealers must comply.

At Bronte we know of no US broker-dealer that has failed at a cost to US clients except by mass fraud. For instance clients of the US Broker Dealer of Lehman Brothers were made whole. They had no losses. The same applies for instance to clients of Drexel Burnham Lambert (the big failure in the last cycle).

Fraud/non-compliance with the 1934 Act unfortunately does not prevent a broker-dealer costing clients money (witness Bernard Madoff Securities – the broker-dealer associated with the Madoff fraud). Another fraud issue was with Refco – a broker dealer that collapsed with about 200 thousand clients in 2005. Massive fraud was involved – but even then clients had considerable recoveries.

London broker-dealer problems (especially Lehman London – the broker dealer that almost collapsed the global economy)

Obviously enough the 1934 Act does not apply to London broker-dealers or their London based clients. A London hedge fund (using a London Prime Broker) can be many times more levered than a US hedge fund using a US Prime Broker.

Moreover a London Prime Broker can borrow against client assets to fund their own business (as per Opes Prime). In the specific case of Lehman Brothers it could borrow against their client assets to finance (say) a commercial property loan portfolio.

When Lehman collapsed it took down the London hedge fund community. Creditors of Lehman London look like getting only 1c in the dollar (a distinct contrast to 100c received by US prime broker clients). Lehman London has a claim in bankruptcy against Lehman US of over $100 billion. That was client money really – pledged to finance Lehman general operations.

This was the transmission mechanism from the Lehman collapse to global crisis. Lehman London dealt a serious capital blow to the most highly levered London hedge funds. Those highly levered funds held debt securities. [To make good money on low spreads debt-based hedge funds needed high leverage and hence congregated in London.] This caused global liquidation of debt assets and was the main mechanism for the global financial crisis.

Why this matters to the Cooper Review?

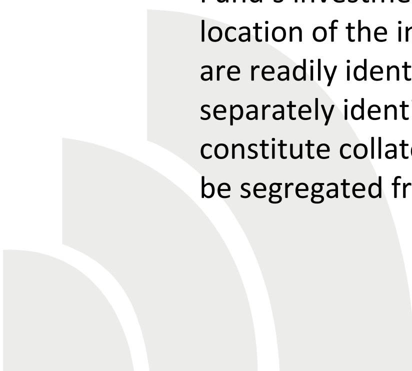
Firstly Australia has totally inadequate broker-dealer regulation – allowing unrestricted pledging of client assets. Many of these assets will be in super-funds. Whilst it is a complicated fix we recommend adopting something closely based on the 1934 Act. This would have prevented Opes Prime and several other near broker collapses.

More importantly – many retail funds managers have all their assets pledged to London broker-dealers and are vulnerable to what happened to Lehman London. Small fund managers do this because it reduces costs to the fund manager. The London broker-dealer will do this for nothing – well – just to get hold of the assets that they can pledge.

This means that if a London broker dealer collapses and Australian client of a retail fund might lose all of their assets. The problem is real.

Here is a disclosure that used to appear on the website of Hayberry – a small fund manager taking retail and superannuation money in Australia:

> **THE PRIME BROKER & CUSTODIAN**
>
> Morgan Stanley & Co. International Plc, a member of the Morgan Stanley Dean Witter Group of companies based in London, will provide prime brokerage services to the Fund under the terms of the International Prime Brokerage Customer Documents (the "Customer Documents") entered into between Hayberry and the Prime Broker for itself and as agent for certain other members of the Morgan Stanley Dean Witter Group of companies (the "Morgan Stanley Companies"). These services may include the provision to the Fund of margin financing, clearing, settlement, stock borrowing and foreign exchange facilities. The Fund may also utilise Morgan Stanley & Co. International Limited, other members of the Morgan Stanley group and other brokers and dealers for the purposes of executing transactions for the Fund.
>
> The Prime Broker will also provide a custody service for all the Fund's investments, including documents of title or certificates evidencing title to investments, held on the books of the Prime Broker as part of its prime brokerage function in accordance with the terms of the Customer Documents and the rules of the Financial Services Authority ("FSA") of the United Kingdom by which it is regulated in the conduct of its investment business. The Prime Broker may appoint sub-custodians, including the Morgan Stanley Companies, of such investments.
>
> In accordance with FSA rules, the Prime Broker will identify, record and hold the Fund's investments held by it as custodian in such a manner that the identity and location of the investments can be identified at any time and that such investments are readily identifiable as belonging to a customer of the Prime Broker and are separately identifiable from the Prime Broker's own investments. Investments which constitute collateral for the purposes of the FSA rules, as described below, may not be segregated from the Prime Broker's own investments and may be available to



creditors of the Prime Broker or the Morgan Stanley Companies. Furthermore, in the event that any of the Fund's investments are registered in the name of the Prime Broker where, due to the nature of the law or market practice of jurisdictions outside the United Kingdom, it is in the Fund's best interests so to do or it is not feasible to do otherwise, such investments will not be segregated from the Prime Broker's own investments and in the event of the Prime Broker's default may not be as well protected.

Any cash which the Prime Broker holds or receives on the Fund's behalf will not be treated by the Prime Broker as client money and will not be subject to the client money protections conferred by the FSA's Client Money Rules. As a consequence, the Prime Broker is not required to segregate the Fund's cash from its own cash, and the Prime Broker may use the Fund's cash in the course of its investment business. The Fund will therefore rank as one of the Prime Broker's general creditors in relation thereto.

As security for the payment and discharge of all liabilities of the Fund to the Prime Broker and the Morgan Stanley Companies, the investments and cash held by the Prime Broker and each such Morgan Stanley Company will be charged by the Fund in their favour and will therefore constitute collateral for the purposes of the FSA rules. Investments and cash may also be deposited by the Fund with the Prime Broker and other members of the Morgan Stanley Companies as margin and will also constitute collateral for the purposes of the FSA rules.

Neither the Prime Broker nor any Morgan Stanley Company will be liable for any loss to the Fund resulting from any act or omission in relation to the services provided under the terms of the Customer Documents unless such loss results directly from the negligence, bad faith, wilful default or fraud of the Prime Broker or any Morgan Stanley Company. The Prime Broker will not be liable for the solvency, acts or omissions of any sub-custodians or other third party by whom or in whose control any of the Fund's investments or cash may be held. The Prime Broker and the Morgan Stanley Companies accept the same level of responsibility for nominee companies controlled by them as for their own acts. The Fund has agreed to indemnify the Prime Broker and the Morgan Stanley Companies against any loss suffered by, and any claims made against, them arising out of the Customer Documents, save where such loss or claims result primarily from the negligence, bad faith, wilful default or fraud of the indemnified person.

The Prime Broker is a service provider to the Fund and is not responsible for the preparation of this Memorandum or the activities of the Fund and therefore accepts no responsibility for any information contained in this Memorandum. The Prime Broker will not participate in the investment decision-making process.

(Short form summary).

1. The Prime Broker describes an ideal world where client assets are kept segregated and are readily identifiable. This is as per the UK Financial Services Authority (FSA)

rules.

2. It says the Prime Broker (Morgan Stanley UK) will follow the FSA rules <u>except</u> where the assets are deemed to be collateral.

3. It says however that the FSA rules will not apply to cash and hence the client is subject to credit risk on the cash.

4. It says that the prime broker will provide services more generally for the client however <u>all</u> of the assets of the client will be considered collateral for the fees for the services.

5. Hence it says that all assets are not subject to the FSA rules.

Note what is going on here. Retail and unsophisticated clients risk losing 100 percent of their money to wrong financial crisis <u>even when they believed they were in a diversified fund</u>. This sort of arrangement is not uncommon and is deeply problematic.

Unless we fix broker-dealer and client pledging arrangements <u>in such a way that clients cannot contract out of them</u> we run very serious system risks in superannuation.

A fix would also remove the problem that Australia has with contracts-for-difference providers where client money and firm money is hopelessly intertwined.

At Bronte we recommend adopting something similar to the provisions of the 1934 Act along with the 1934 Act stipulation that the provisions cannot be contracted away.

(I note that ASIC staff who have commented on this submission have suggested that ASIC have some way of attacking funds which are structured like Hayberry. However such funds seem pervasive at the lower end of the market.)

Custody and client-asset security – lessons from the Astarra debacle

The Astarra Strategic Fund appears to be a simple fraud. Returns were stated (that is made up) to look attractive. These returns supposedly came from investing in a British Virgin Islands vehicle that held a fund-of-hedge-funds. Moneys were wired to the BVI (or in reality to Hong Kong) and were never seen again. Of course if the money turns up then an hypothesis of fraud can probably be dismissed. As of writing the principals of Astarra have had about four months to find the money and the administrator (PPB) has stated that neither they nor anyone else has evidence for the *existence* of the assets. By contrast however Peter Johnston of the Association of Independently Owned Financial Planners (AIOFP) believes all the assets are easily accounted for. This submission assumes that – consistent with the administrator's current view – that the Astarra assets are not to be found. (We wish to remain open the the increasingly unlikely alternative. That is it is possible the assets will turn up...)

The principals of Astarra controlled a superannuation wrap products into which clients invested the entirety of their superannuation. [A wrap is just a device for investing in many funds, completing superannuation tax compliance and stripping off fees to pay the financial planner.] Normally a wrap (say Colonial One Source or another major product) would hold the entirety of a client's superannuation. As the wrap is diversified – holding funds produced by many fund managers – the only way the wrap could collapse is through fraud.

We note the Astarra wrap products are currently in administration. This is fundamentally different from every other fund manager collapse in Australia in that it is a wrap provider collapse. When (say) Basis Capital collapsed it resulted in clients losing one fund amongst many they were invested in. When the Astarra wrap collapsed clients potentially lost all their funds. In the Astarra case some assets will remain – but primarily because ASIC worked fast in reacting to the tip-off letter that John Hempton (of Bronte) sent.[2]

The purpose of this part of the submission is to show how to prevent this sort of event happening again. These methods will also stop Ponzi frauds and other major scams occurring. First however I should explain how a reputable fund might work. [Bronte works slightly differently – but what is described is vanilla for a mutual fund.]

The administrative functioning of a well-run global equities fund

Imagine a vanilla global equities fund domiciled in Australia. It may buy and sell equities in say 50 jurisdictions including some quite obscure ones. [For instance a reputable fund might choose to buy equities in Arab Bank – a major Middle East Bank based in Jordan.[3]]

[2] The tip-off letter was sent via Ken Henry of the Treasury. It arrived at ASIC as an email from Dr Henry to Tony D'Aloisio. We do not know whether ASIC would have responded so effectively to a tip-off coming through the bottom rungs of the bureaucracy.

[3] Just to make the point – Arab Bank is run by Maronite Christians (who have no usury constraint) in an area dominated by Muslims. Naturally it has developed a large private banking business with access to rich Middle East investors. It is a substantial – and possibly attractive company in what is economically otherwise a very minor jurisdiction.

The fund will have someone who is authorised to trade (usually a "trader") who in fact places orders with a broker (which can be any broker including say a small brokerage in Jordan). The trader will place the order with the broker and report the trade to the fund's back office and simultaneously the fund's external custodian.

The back office will "match" the trade – confirming that details as sent by the broker exactly match (to the penny) the trade as confirmed by the trader. The matched trade is sent to the external custodian.

The external custodian is usually a large independent custody bank. Two banks – State Street and Bank of New York – both with over 10 trillion dollars in custody – dominate this business.

The external custodian will also match the trade with the broker. Note here that the fund manager never touches the client cash or securities and hence is not in a position to steal them.

The external custodian will do asset valuation daily or monthly to match the redemption dates of the fund. The fund manager will also typically do this asset valuation. These valuations will differ slightly because of things like currency (do you use bid or offer, do you use New York settlements, London or Sydney) and things like whether you record the value of certain after market trades. But the values will not differ by much. Provided the valuations are consistent you can be sure that new clients are treated fairly.

When the external custodian settles a trade they send cash and receive securities. These better have values that match (at least at trade time) or the custodian should panic. The fund is exposed to Herstatt risk[4] in some instances – but only on the unsettled trade valuation. As long as fund turnover (per day) is low compared to the value of the fund this risk is acceptable. Still at no point is an unrequited transfer made.

Unrequited transfers – and the risk therein

An unrequited transfer is when the custodian sends cash or securities and does not get similar value back. Unrequited transfers are where risk of theft mostly resides.

A typical unrequited transfer is a derivative cash settlement. The foreign equity fund might have considerable hedging arrangements in place – for instance say hedging back to Australian dollars 50 percent of its exposure. That would mean that they are long Australian dollars and short the foreign currency via a derivative.

If the Australian dollar were to rapidly drop 25 percent (something that does happen) then the fund (that is the custodian) would be required to send as settlement for hedging losses

[4] Herstatt Risk is risk arising from difference in time of delivery of cash versus security or one currency versus another. The famous example is Herstatt Bank which received payments in Germany in Deutsch Marks in the morning against payment in the US of US dollars later in the same day. Herstatt failed in the middle of the day and gross settlement values were lost by the US counterparties. Obviously similar settlement issues will arise with a fund sending cash from Australia versus delivery of securities in later time zones.

12.5 percent of the funds under management and it would be an unrequited transfer. No securities travel in the opposite direction.

The custodian better know for sure that this transfer represents a real derivative loss rather than (say) theft of 12.5 percent of the funds under management.

The way that they do this is that they insist on knowing as soon as possible about the derivative exposure. When the derivative is entered into the "trade" needs to be matched in a similar way to the equity trade described above. In some instances some custodians require matching (often by computer) within half an hour.

Then the custodian will value the derivative each day – and when settlement day arrives the amount of settlement is not a surprise but matches the custodian's (and presumably the fund manager's) expectations.

More of a risk is buying shares in an IPO. If the IPO were by a major bank in the United States then the custodian could fairly confidently send money as per the description in the prospectus. All they would get back is a promise that when the IPO closes (perhaps several weeks away) they would get either the cash back or some securities which are unknown value[5]. However – say for example the fund manager wanted to buy securities in an IPO in Tajikistan? The securities are highly uncertain (even if they were the Tajikistan phone company). The bank receiving the money might be a local bank in Tajikistan that nobody in Australia has heard of. Even the prospectus might be hard to obtain or extremely short-form and crude. At this point the custodian has to exercise judgement. **This is not a business that can be entirely computerised – some judgement is required**.

Some unrequited transfers should simply not be allowed. For instance if the fund manager were to ask the custodian to send $10 million to their personal account because they want to spend it on cocaine and high class hookers the custodian should (of course) refuse. In the Astarra Strategic Fund case the custodian (National Australia Bank) was asked to send money to an entity in the British Virgin Islands (EMA International) for whom they could identify neither the custodian nor the directors. To my surprise they did this – though they may have sent the money via a Hong Kong bank account with Standard Chartered. I can't see the difference between this behavior and sending it to the fund manager's personal bank account – at least as far as client safety is concerned.

I suspect in the Astarra case that National Australia Bank will need to make good the missing money – which will be in excess of 100 million. If the fraud were 200 times as large (possible given the scale of the Australian Superannuation system) then National Australia Bank would fail.

Anyway what is required is a clear separation between asset custody and the fund manager with duties for the asset custodian. The duties for the custodian should only be what would normally be expected of a custodian – nothing fancy. Just nothing like what National Australia Bank did with Astarra client money.

[5] They are of unknown value primarily because they have never traded.

This will require considerable consultation to legislate as there are other acceptable client custody arrangements. [Bronte for instance uses a standard prime broker arrangement using US prime brokers and hence protected by the 1934 Act.] We make no specific recommendations other than the current regime of "single responsible entities" is deeply flawed and should be abandoned. All good processes require a separation of duties as a check.

How big a problem is this? The examples of National Australia Bank and Macquarie Bank

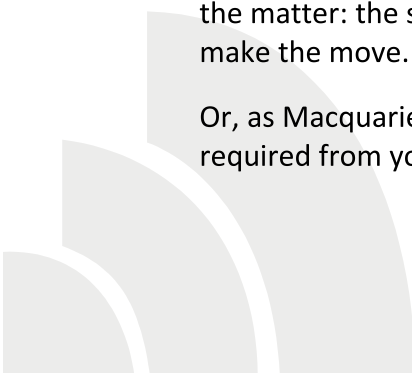
National Australia Trustees is the Custodian for the MLC (ie National Australia Bank) Wrap product. Our understanding is that over $100 billion of (mostly) superannuation money is in custody here and there is no separation between the custodian and the product provider. Fraud is a real possibility and National Australia Bank have not proven themselves competent custodians in the Astarra case.

National Australia Bank used to use State Street as an external custodian – but they bought the function in-house when the single-responsible entity regime was enacted. This increased the fraud risks to a great extent.

If you do not believe this is a problem then consider the case of Macquarie Bank. Macquarie runs a wrap product – a white labeled product where clients of retail financial planners park their superannuation money. Inevitably this superannuation money is – at least partly – held in cash.

Macquarie used to invest this cash in a cash management account holding a diverse range of short-dated highly rated paper (including government paper). Macquarie – in the midst of the financial crisis decided to instead take this money out of cash management account and put it on deposit at Macquarie. (This was before the government guarantee of bank deposits.) This was reported in the following Sydney Morning Herald story:

> Macquarie finds $1b under nose
> **STUART WASHINGTON**
> *June 10, 2008*
> MACQUARIE GROUP just found a cool $1 billion under its bed to address the high price of debt - or actually, under the beds of pensioners and superannuation investors.
>
> With little fuss, Macquarie has converted the cash accounts of investors in its super manager and pension manager "wrap" investment products into deposits in Macquarie Bank.
>
> Investors with a total of $1 billion in cash accounts have been given little choice in the matter: the switch occurred in May whether or not the investors wanted to make the move.
>
> Or, as Macquarie told its investors in a leaflet about the change: "No action is required from you."

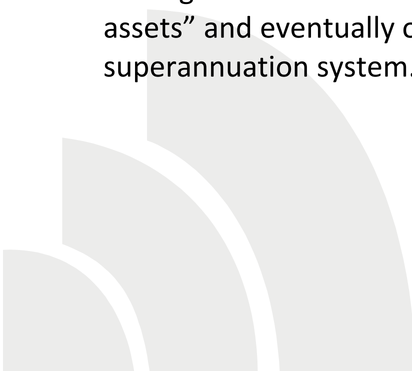


> Investors have been swapped from the AAA-rated Macquarie Treasury Fund - which invests in a variety of money market products - into a deposit with Macquarie Group's banking division, which is rated two notches lower at A-1.
>
> Investors have to deliberately opt out of the move by switching their cash into another cash fund if they do not want to become a depositor with the bank. Even then, they will have to maintain a minimum of $2500 in the cash account as a deposit in Macquarie, as part of their participation in the "wrap" investment platform.
>
> For a bank, more deposits are a bonus because they are a cheaper source of funding than is available on the wholesale debt-funding market.
>
> As a result of the liquidity crisis, the amount a bank pays for its wholesale funding has grown dramatically, with banks paying up to 2 percentage points more than before the crisis pushed up prices.
>
> The official line on the switch is that the trustee, Macquarie Investment Management, found an opportunity for a 0.2 percentage point increase in investor returns for the cash account of the superannuation and pension products.
>
> "It's the trustee deciding to get a better return for clients," Macquarie's head of product, Tony Graham, said.
>
> Macquarie Group will not receive more fees from the change.
>
> Australian depositors are protected by strict regulations. But a product disclosure statement notes a deposit in Macquarie is not diversified among a number of products, as was the case with the Macquarie Treasury Fund.
>
> "It is a concentrated investment in a single asset, being a deposit with Macquarie Bank," it says.

Note that what Macquarie did was borrow a billion dollars of client money at precisely the time that Macquarie had solvency (or liquidity) difficulties. There is simply no way that this would have been allowed had State Street (a reputable trust company) held custody over the Macquarie wrap.

In most jurisdictions what Macquarie did would be called theft. However in Australia – because of our Single Responsible Entity laws what Macquarie did is probably legal and certainly unlikely to be prosecuted.

Bronte's suggestion: repeal the SRE rules and replace them with something more suitable. If the government does not do this then "borrowing client assets" or just "misplacing client assets" and eventually outright Ponzi frauds will become a defining feature of the Australian superannuation system.



<u>Attachment A</u> – a short letter from the SEC

Bronte Capital has both US and Australian relevant fund manager licenses. As a US license holder we received this email:

> SEC Adopted Amendments to Investment Advisers Act Rule 206(4)-2, Rule 204-2, and Form ADV
>
> Hello SEC-registered Investment Advisers: The SEC adopted amendments to Investment Advisers Act Rule 206(4)-2 (Custody of funds or securities of clients by investment advisers), Rule 204-2 (Books and records to be maintained by investment advisers), and Form ADV in December 2009. You may view the final release and rule amendments at http://www.sec.gov/rules/final/2009/ia-2968.pdf. TheSEC also adopted interpretative guidance for independent public accountants in connection with the revised custody rule, which can be viewed at http://www.sec.gov/rules/interp/2009/ia-2969.pdf. The revised custody rule may require you (subject to specific facts and circumstances) to: (1) have a reasonable belief that your clients' custodians directly send account statements to them; (2) engage an independent public accountant to conduct a surprise examination in 2010; (3) obtain or receive from an affiliated qualified custodian an internal control report in 2010; (4)include in the notice to clients required by the custody rule when you open a custodial account and upon changes, and in subsequent client account statements, a legend urging clients to compare account statements sent by the custodian with those sent by the adviser; (5) engage an independent public accountant that is registered with, and subject to inspection by, the PCAOB, if you advise pooled investment vehicles and rely on the rule's annual audit provision, for audits of fiscal years beginning on or after January 1, 2010; and (6) Provide additional information on Form ADV regarding your custody practices (Form ADV revisions scheduled for Fall 2010). Please review the adopted amendment to determine whether or not you must comply with these and other changes made to the rule. You can not reply to this email for further information. If you have any questions, please email IARULES@SEC.GOV. Thank you.
> http://www.sec.gov/rules/final/2009/ia-2968.pdf

The SEC has had to reform practice after Madoff and a swathe of Ponzis exposed during this market downturn. Australia should use the Astarra example to implement rigorous reform.