Chapter 7

The 'expectation gaps' and some possible remedies

Introduction

7.1 The evidence of chapters 3, 4, 5 and 6 indicates that investors in Trio Capital were either unaware of, or had different expectations of the remit and function of the regulators, auditors, custodians, research houses and financial advisers. In evidence to the committee, these differences were termed 'expectation gaps'. These 'gaps' are as follows:

- first, and most significantly, most Trio investors in self-managed superannuation funds (SMSFs) seemed not to be aware that their investment was not protected to the same extent as investments made in Australian Prudential Regulation Authority (APRA) regulated superannuation funds. This has been a clear and recurring theme during this inquiry and is of particular concern to the committee;
- second and related, there is an expectation among investors that financial advisers will check the investments that they recommend to their clients, to ensure not only that there are prospects for good returns but that they are run legitimately;
- third, there is a lack of understanding as to how Australian Financial Services Licences (AFSLs) are issued. The AFSL attaches to the company, not the directors;
- fourth, both the regulators and investors have expressed frustration at the role of Trio Capital's financial statement and compliance plan auditors, particularly their inability to verify information. The auditors cite the limitations on their role and that the primary responsibility for detecting fraud rests with the responsible entity. They note that auditors can only obtain reasonable assurance that a financial report is free from material misstatement, whether caused by fraud or error;
- fifth, there is an expectation in the public mind that custodians will act to protect and secure the underlying investment. By contrast, Trio's custodian, the National Australia Trustee Limited, has noted that the custodian does not have the expertise to question underlying values of either domestic or offshore funds;
- sixth, there is a lack of understanding as to the claims made in the reports issued by research houses and in particular, whether the data provided by the responsible entity upon which these reports are based has been verified. There is also some confusion as to whether the ratings are intended as an indicator of future performance, or simply an assessment of past performance; and

- finally, Australian Securities and Investments Commission (ASIC) has noted that, compared to the United States and Europe, the level of underlying portfolio disclosure of managed investment schemes in Australia is very limited. Both ASIC and Morningstar have suggested there should be disclosure at asset level for registered managed investment schemes to help investors assess both the type of financial products they are exposed to, and the extent of that exposure.

7.2 This chapter discusses each of these gaps and makes several recommendations. It concludes by emphasising that addressing these expectation gaps will require a focussed effort on the part of ASIC, the Australian Taxation Office (ATO) and financial planning bodies, to educate SMSF investors about the inherent risks and complexities in managed investment schemes. These efforts must be made in conjunction with the actions proposed in this chapter's recommendations.

Informing and protecting SMSFs

7.3 The main 'expectation gap' in the Trio Capital collapse was the belief of many SMSF investors that they would be protected from, and compensated for, fraud and theft. The issue of compensation was considered in some detail in chapter 3. Chapter 6 noted that many investors expressed genuine surprise and shock that they did not enjoy the same protections as those afforded to investors in APRA-regulated superannuation funds. Some were even unaware they were investing in Trio funds through an SMSF. The committee notes that many, perhaps most, superannuation investors do not consider whether there is compensation available in the event of fraud and theft before they choose their superannuation fund (be it an APRA-regulated fund or an SMSF.

7.4 The committee acknowledges the anger and frustration of many SMSF investors in Trio Capital who were not aware that as an SMSF, they were operating in a different regulatory environment. The committee considers that, by and large, the problem was not that these SMSFs were investing recklessly, but that they were not informed of the risks.

7.5 The committee believes there are important steps that should be taken to remedy this situation. First, and most obviously, there is a key role for the ATO and ASIC to better inform SMSF investors of their responsibilities, their legal duties and their exposure to risk. At a minimum, the ATO's website must have a clear, understandable, large print warning placed on its website explaining that SMSF trustees are not covered in the event of theft and fraud.

Recommendation 3

7.6 The committee recommends that the Australian Taxation Office include a clear, understandable, large print warning on its website that self managed superannuation fund trustees are not covered in the event of theft and fraud. This warning must be effectively communicated to all existing Self Managed Superannuation Fund trustees through the guidance material of the Australian Securities and Investments Commission.

7.7 In addition, the committee believes that the guidance material provided by the Australian Taxation Office must explain the difference between the regulatory protections offered to members of APRA-regulated superannuation funds under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and the limited protections offered to SMSF investors under the *Corporations Act 2001* (Corporations Act).

Recommendation 4

7.8 The committee recommends that the guidance material provided by the Australian Taxation Office for Self Managed Superannuation Fund investors clearly state the difference between the protections and compensation arrangements for investors in funds regulated by Australian Prudential Regulation Authority as distinct from the limited protections available to Self Managed Superannuation Fund investors.

7.9 Notwithstanding the need for these warnings and disclosures, the obvious question arises as to whether this is at all an adequate response to the Trio case. There is a strong argument that while warnings and guidance materials for SMSF investors in relation to fraud may alert investors, they will not generally dissuade the investment. For one, the chances of losing superannuation money to fraud and theft in Australia remain statistically low. Moreover, when a financial adviser recommends the investment, the SMSF investor is naturally more concerned about the likely rate of return than the possibility of theft or fraud.

7.10 The committee notes that it is also difficult to envisage that a website warning or guidance material alone will lead SMSF investors to conduct the type of forensic analysis required to uncover a fraud of the sophistication of Trio before being burnt. Even Mr Hempton 'blew the whistle' well after the fraud had occurred and even then, was unsure whether there had in fact been fraudulent activity. Put simply, SMSF investors may not have the time, the insight or the knowledge to detect complex fraudulent activity.

7.11 The issue then becomes how SMSF investors can be protected in the rare event that they become a victim of fraudulent activity. On this matter, the committee makes two points. The first is to reiterate the recommendation in chapter 3 that the St John inquiry into a statutory compensation scheme for financial services must consider how compensation should work in investment structures where investors do not have the benefit of the SIS Act compensation scheme. As chapter 3 discussed, one

option could be to place a levy on managed investment schemes covering SMSF investors for theft and fraud.

7.12 The committee's second proposal—potentially an alternative to an investment scheme levy—is to allow SMSFs that want to be covered for theft and fraud protection to do so through registering with APRA. This process would be subject to all necessary prudential licensing and knowledge requirements.

SMSFs and the role of financial advisers and planners

7.13 It is not surprising that many of those investors who lost money in the Trio Capital collapse directed their anger and frustration at the financial adviser, who recommended the investment. Chapter 6 presented these views. Quite apart from any expectation on the rate of return, investors expect that financial advisers will recommend an investment that is legitimately operated and properly regulated.

7.14 Following the introduction of the Future of Financial Advice (FoFA) legislation, financial advisers will have a fiduciary duty to act in the best interests of their clients and to put their clients' interests ahead of their own when providing advice. There is also a ban on the payment and receipt of certain remuneration which has the potential to influence the financial product advice given to retail clients.[1] Financial advisers will be required to make full and timely disclosure of commissions to investors. The provisions will in the future restrict certain conduct which appears to have been engaged in by advisers in the Trio case and which at that time did not breach any law.

7.15 However these provisions would not protect against a circumstance where an adviser 'turns bad' and sets out to either defraud his clients, or at the very least to concentrate on enriching himself while wilfully disregarding the evidence that the investment scheme into which he is putting his client's money was fraudulent. In the committee's view this is an accurate description of what occurred with Paul Gresham. The committee notes that if an adviser chooses to behave fraudulently or illegally, writing new laws will not add any protection; what is required is more effective enforcement of existing laws.

7.16 The committee highlights the fact that advisers, financial planners and in the majority of cases accountants, provide a critical entry point on establishment of an SMSF. It is concerning, on the evidence before the committee, that many Trio investors were not aware they were not entitled to compensation. This poses the fundamental question of what advice, if any, was provided by planners and

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1 See Parliamentary Joint Committee on Corporations and Financial Services, *Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, February 2012, http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/future_fin_advice/report/index.htm (accessed 20 April 2012).

accountants. The committee is particularly interested in establishing what advice was given to SMSF investors in Trio Capital by financial planners and advisers.

Recommendation 5

7.17 The committee acknowledges the Future of Financial Advice reforms, particularly the provisions addressing conflicted remuneration. Nonetheless, it recommends that ASIC conduct a specific and detailed investigation of both planners' and accountants' advice to SMSF investors in Trio Capital. This investigation must examine what information was provided to these investors regarding their duties and responsibilities, and whether they were informed—either verbally or in writing—that they are not entitled to compensation in the event of theft and fraud.

SMSFs and the role of the ATO

7.18 Another aspect of the issue of protecting SMSF investors concerns the role of the ATO. From the evidence in chapter 4, it is clear that (in contrast to APRA) the focus of the ATO is not on the level of risk-taking of SMSF investors, but on ensuring that there is an investment strategy which is not for the purpose of tax avoidance. In the Tax Commissioner's own words, 'the nature, effectiveness and risk of their investment is really a matter for the trustees, subject to certain rules in the law which say that certain investments are not able to be entered into'.[2]

7.19 The key point is that the ATO does not offer protection for SMSFs. Rather, it is the registration notice point for SMSFs, ensuring that SMSFs have a clear investment strategy and that they are not being used as vehicles for tax avoidance. Given this remit, the ATO is indifferent to the risks of fraud and theft to which SMSF investors are exposed. It is not its responsibility to minimise these risks.

Australian Financial Services Licensing arrangements

7.20 Another point of confusion for many Trio Capital investors related to AFSL arrangements. Chapter 4 noted that ASIC issues licences to the entity, rather than the individual. However, as chapter 6 observed, several Trio Capital investors criticised ASIC for giving an AFSL to Mr Shawn Richard. As one submitter argued:

> By investigating the role of ASIC and APRA you will find that had they correctly reviewed the licensing application information and PDS documents and undertaken Due Diligence and applied correctly their Duty of Care then Shawn Richard would never have been given a license and as a result Trio Capital would not have been established. As a final outcome the investors would have been protected from the eventual fraud.[3]

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2 Mr Michael D'Ascenzo, Commissioner, Australian Taxation Office, *Committee Hansard*, 23 September 2011, p. 33.

3 Name withheld, *Submission 13*, p. 1.

7.21 Mrs Fay Gammel made a similar observation:

> Why were Financial Licenses issued by the Regularity (sic) Authorities when the past history of a number of these operatives was known to be "dodgy"? Mr Shawn Richard seems to be a typical example.[4]

7.22 There is a clear expectation that undesirable elements should be kept out of the financial services sector through tighter regulation of licenses. However, as ASIC noted in its submission, there are limitations in the current licensing system:

> ASIC's ability to protect investors by restricting entry into, or removing participants from, the financial services industry who might cause or contribute to investor loss is limited under the current FSR [Financial Services Regulatory] regime. This is because the current FSR regime:
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> - sets the threshold for obtaining an AFS licence relatively low and the threshold for cancelling an AFS licence relatively high; and
> - focuses on the licensed entity rather than the directors, employees or other representatives.[5]

7.23 The committee draws attention to the discussion in chapter 4 on the reforms to ASIC's licensing powers contained in the FoFA legislation, which passed in the House of Representatives in March 2012. The Bill would amend the relevant sections of the Corporations Act to give ASIC greater discretion in granting and cancelling AFSLs. Chapter 4 noted ASIC's comment that had these provisions been in place when the Trio fraud was happening, 'it may well have enabled ASIC to act at an earlier stage'.[6]

7.24 This will come as no consolation to Trio Capital investors. Nor will the FoFA amendments change the current situation of an AFSL attaching to the business, rather than individual directors. As chapter 2 noted, Shawn Richard, Cameron Anderson and Matthew Littauer, through their indirect control of Wright Global Asset Management, acquired the reputable funds manager Tolhurst (later AFM) in November 2003. ASIC issued Tolhurst an AFSL in March 2004 as part of the new licensing regime, thereby making Mr Richard, Mr Anderson and Mr Littauer the directors of a company with an AFSL.

7.25 In the committee's opinion, the Trio case does reflect a problem with the current licensing system. The fact that ASIC does not make checks when there are changes in ownership of an AFSL creates a loophole for a would-be criminal syndicate looking to acquire a reputable company holding an AFSL.

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4 Mrs Fay Gammel, *Submission 21*, p. 4.

5 ASIC, *Submission 51*, p. 21.

6 Mr John Price, Senior Executive Leader, ASIC, *Committee Hansard*, 6 September 2011, p. 5.

Recommendation 6

7.26 The committee recommends that the government consider whether current processes are adequate when there is a change of ownership or control of a company which holds an Australian Financial Services Licence, or whether there is a need for more detailed scrutiny of the new owner.

The role of auditors

7.27 A third and significant 'expectation gap' concerns the role of auditors. The views of Trio Capital's auditors—WHK, the external auditor and KPMG, the internal auditor—were canvassed in chapter 5 of this report. Chapters 4 and 6 presented criticisms of their roles by ASIC and APRA, and by Trio investors.

7.28 As discussed in chapter 4, the main theme of APRA's evidence to the committee was that, in a case like Trio, it is reliant on auditors to check the accuracy of the information that is supplied to it. APRA noted that in 2007 and 2008, the fund received 'an unqualified audit sign-off'.[7]

7.29 ASIC also offered pointed criticism of the role of the auditors in the Trio case, but noted that this was due to systemic failure. As ASIC's Chairman told the committee, 'there are checks and balances that we felt were built into the managed investment scheme (MIS) system that are just not working the way perhaps it was contemplated originally'.[8] Chapter 4 outlined ASIC's views on possible reforms to enhance the effectiveness of compliance plans and compliance committees.

7.30 Chapter 5 noted KPMG's view that there is an 'expectations gap' between what the public believe he work of a compliance plan auditor to be, and the work that by law the auditor is required to perform. Specifically, it argued that stakeholders often have erroneous expectations that: auditors are primarily responsible for the preparation and presentation of financial statements; that 'clean' audit opinion provides absolute assurance over the accuracy of the financial statements and guarantees the entity's future solvency; that auditors perform a 100 per cent check over all items recorded in the accounts; that auditors are to provide early warning regarding the possibility of a corporate collapse; and that an auditor's role includes detecting all fraud.

7.31 KPMG argued that these expectations contrast with the legal obligations of the auditing profession. In particular, it noted that auditing standards require an auditor to plan and conduct an audit to obtain 'reasonable (as opposed to absolute) assurance' that the financial statements are free from material error and fraud. This does not mean that auditors are required to certify or guarantee the accuracy of the financial statements or that the business model is sound. It added: 'there is a clear

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7 Mr Ross Jones, Deputy Chairman, *Committee Hansard,* 30 August 2011, p. 38.

8 Mr Greg Medcraft, Chair, ASIC, *Committee Hansard*, 6 September 2011, p. 7.

opportunity for education and improving the understanding of the public at large as to the nature and scope of the auditor's role'.[9]

7.32 As chapter 4 noted, KPMG considered that the expectation gap could be reduced 'through AUASB and ASIC working together to provide additional guidance'.[10] It also argued that there could be greater guidance in terms of standards relating to the conduct of a compliance plan audit.

Committee view

7.33 The committee is particularly concerned at the 'expectation gap' between what is expected of auditors and what they are actually responsible for doing. This 'gap' relates to some fundamental issues. In particular, it is of concern that auditors' approval of financial statements does not necessarily mean that the actual assets underlying the financial statements exist. Further, an auditor's assessment of a compliance plan and the work of the compliance committee as effective essentially only means that they exist. Clearly in the case of Trio, the requirement for the auditors to demonstrate 'professional scepticism' about the information given to them was insufficient to prevent the loss of investors' funds.

7.34 The committee believes that the government should investigate the areas that ASIC has identified to improve the operation of compliance plans and compliance committees. In particular, there is merit to the suggestion of an approval process for compliance plan auditors so that ASIC has the powers to remove or impose conditions on such approval. In terms of compliance plans, the committee urges the government to examine ASIC's proposal to review the effectiveness of the role of these plans and if necessary, require more details to be provided in these plans. The committee also recommends that the government consider minimum requirements for compliance committees and the membership of these committees.

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9 KPMG, *Submission 69*, p. 12.

10 KPMG, *Submission 69*, p. 14.

Recommendation 7

7.35 The committee recommends that the government investigate options to improve the oversight and operation of compliance plans and compliance committees. In particular, this investigation should focus on the need for:

- **more detail to be included in compliance plans;**
- **qualitative standards by which compliance plan auditors must conduct their audits;**
- **liability for the responsible entity and its directors for any contravention of the compliance plan, rather than only for material contraventions, as is currently the case;**
- **legislative requirements as to experience, competence or qualifications for compliance committee members;**
- **regulatory or member oversight of the appointment of compliance committee members;**
- **an approval process for compliance plan auditors so that ASIC has the powers to remove or impose conditions on such approval; and**
- **governance arrangements to be clearly stated in relation to the proceedings of the compliance committee.**

The role of custodians

7.36 The Trio Capital collapse also exposed the limitations of the role of custodians (see chapter 5). Several submitters noted that the custodian had not performed its role properly as it had not verified the presence and the value of the underlying assets, and it had not protected the investment.

7.37 ASIC noted in its submission that 'there may be an expectation gap between what is legally required of custodians and what investors expect the custodian to be doing to safeguard their investment'.[11] It drew attention to its current review of custodians and flagged that one aspect of the review will be to consider whether custodians should be more proactive in identifying and reporting suspicious matters involving their clients.[12]

7.38 Chapter 5 noted the views of National Australia Trustee Ltd (NATL), ANZ Custodian Services and the Australian Custodian Services Association. All three drew the committee's attention to the system in which custodians operate, centred as it is on the responsible entity. ANZ wrote in its submission:

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11 ASIC, *Submission 51*, p. 77.

12 ASIC, *Submission 51*, p. 77.

> It has been suggested in submissions made to the Committee that a custodian is required to confirm the existence of a fund's underlying assets. This is incorrect. The custodian's role and function, as bare trustee, is to hold assets on behalf and upon instruction of the RE. Its duty, which is owed exclusively to the RE, is to act on proper instructions from the RE in relation to those assets. The role of the RE is to manage the assets of the scheme, including activities such as investment strategies and valuations. A custodian does not have discretion to choose whether or not to act on a proper instruction which is lawfully given by the RE. The custodian has no discretion regarding the investment or management of the custodial assets.[13]

7.39 Mr Leigh Watson, Executive General Manager of Asset Servicing at the NAB, told the committee:

> The custodian simply does not have expertise under the current regime, because it is not required to, around second-guessing or valuation of funds. Apart from reporting on values—either from independent sources, preferably, or from the manager RE who is responsible for that—the custodian simply does not have the expertise to question underlying values of offshore or even domestic funds. [14]

7.40 Chapter 5 noted that custodians may only know if the assets for which they are acting as custodian actually exist when they are asked to redeem the funds in order to make a payment. In this context, the NAB suggested that the committee may wish to consider whether there should be an obligation to report to a regulator if the instructions from the responsible entity carried out by the custodian found that assets did not exist.[15]

Committee's view

7.41 On the evidence before it, custodians appear to have a limited role in managed investment schemes of the kind conducted by Trio, and by many legitimate financial services providers. The custodian does virtually nothing to protect the funds of investors. It makes no independent checks before transferring money offshore. Instead, the custodian simply acts on the instructions of the responsible entity.

7.42 It is the committee's view that there is a clear expectation gap between what retail investors understand as the role of the custodian and what a custodian is legally required to do. The committee strongly supports ASIC's program to review custodian businesses and identify those issues requiring regulatory reform. In particular, the

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13 ANZ, *Submission 70*, p. 3.

14 Mr Leigh Watson, General Manager of Asset Servicing, National Australia Bank, *Committee Hansard*, 23 September 2011, p. 14.

15 Mr Stephen Tudjman, General Counsel MLC, National Australia Bank, *Committee Hansard*, 23 September 2011, p.16.

committee urges ASIC to consider the safeguards that a custodian could put in place to ensure it able to identify and report suspicious transfers that do not trigger the anti-money laundering provisions.

7.43 In this context, the committee considers that the word 'custodian', particularly as used in product disclosure statements, is inappropriate. It urges ASIC to find another term, one which does not give unwarranted reassurance to investors. One option could be a 'Manager's Payment Agent'.

Recommendation 8

7.44 The committee recommends that as part of its review of regulatory arrangements relating to custodians, ASIC should consider changing the name 'custodian' to a term that better reflects the current role of a custodian. This new term—reflecting the limited role of custodians—must be used in Product Disclosure Statements.

The role of research houses

7.45 The collapse of Trio Capital has also exposed differences in the way investors and advisers view the work of research houses on the one hand, and the reality of how this work is conducted and how it should be interpreted on the other. There are two issues. First, there appears to be a perception among investors that research reports and ratings are a comment on future performance of a fund. This is not the case—the reports are solely an analysis of the past performance of the investment. Second, there is a reasonable expectation among investors that research houses will verify the data upon which their reports and ratings are based. Again, as chapter 5 explained, this is not the case.

7.46 As was the case with the auditors, the custodians and to a lesser extent APRA, Morningstar relied on the information provided by Trio without verifying whether the data was accurate. This is not to suggest that Morningstar acted improperly. Rather, it reflects the structure of the system, built as it is on the responsible entity acting honestly.

7.47 The committee notes that ASIC has been conducting a consultation process with a view to updating its Regulatory Guide on managing conflicts of interest for research report providers.[16] A consultation paper was released in November 2011 and the release of an updated regulatory guide is expected in May 2012. The consultation paper deals with issues including managing conflicts of interest, the methodology and transparency of the research and the quality of the research in terms of the resources devoted to it.

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16 Regulatory Guide 79, *Managing conflicts of interest: An ASIC guide for research report providers*.

7.48 However, there is no mention in ASIC's consultation paper of the issue specific to research houses and the collapse of Trio; namely, that the data provided to research houses by the responsible entity is not independently verified. The committee believes that this is an important issue to consider. ASIC's planned work on the role of managed investment scheme compliance plans, auditors and committees would provide important assurances for research houses that their work is based on accurate data.

Better disclosure by managed investment schemes

7.49 The seventh and final 'expectation gap', and possible area for reform, relates to the disclosure requirements of managed investment schemes. Clearly, in the case of Trio, there was fraudulent activity perpetrated through the Astarra Strategic Fund (ASF) and the ARP Growth Fund. The question has arisen during this inquiry as to whether the regulators, the auditors, the research houses, the financial advisers and investors themselves would all benefit from better disclosure by the managed investment schemes of their asset portfolio holdings.

7.50 ASIC raised the possibility of whether there should be disclosure at asset level for registered managed investment schemes to help investors assess both the type of financial products they are exposed to and the extent of that exposure.[17] It noted that currently:

> [T]here is no current statutory requirement for a responsible entity of a registered managed investment scheme to disclose its scheme assets at the asset level. Therefore, there is no means by which scheme members can legally require specific information on the portfolio holdings of the registered managed investment schemes in which they have invested. Absent the responsible entity providing this information on request of the scheme member voluntarily, investors cannot assess their exposure to particular assets associated with particular registered managed investment schemes and take this into account when considering whether or not they should continue to hold those investments.[18]

7.51 ASIC Chairman, Mr Greg Medcraft, raised this issue of the underlying portfolio level of disclosure in his evidence to the committee. He explained:

> At the end of the day, if you think about this system, the basic premise of the system is about efficient markets, and efficient markets are about making sure that there is not an asymmetry of information. I think here that, if you cannot actually find out what is in the underlying portfolio, it is a key weakness in terms of not having that information available to investors.[19]

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17 ASIC, *Submission 51*, p. 63.

18 ASIC, *Submission 51*, p. 63.

19 Mr Greg Medcraft, *Committee Hansard*, 6 September 2011, p. 6.

7.52 Mr Medcraft elaborated on this issue before a Senate Estimates hearing in October 2011:

> My view is that any investor—whether it be in a super fund or a managed investment scheme—should be entitled to see what the underlying assets of that fund are. As a former fund manager and banker, I think that every investor should have the fundamental right, whether it be with a non-disclosure agreement or whatever, to see what the underlying investments are. I think it is common sense.
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> ...
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> I think that is almost globally accepted because the investors' one has the most skin in the game; it is their money. From being overseas and in different markets, I was surprised when I came back to learn that our level of underlying portfolio disclosure in Australia was very limited when you compare it to markets like the United States or Europe. I think this was recognised in the Cooper review, which made recommendations to the government in terms of having underlying disclosure at six-monthly intervals to take a picture twice a year and have that available to investors. If we look at other markets, as I say, the United States has full portfolio level disclosure of funds on a quarterly basis within, I think, 30 days. It clearly can be done. It is done in other markets. I think it is quite important. Our system in Australia is a very open, free system and what we say to investors is that you have got to take responsibility for your investment decisions. I think that is consistent that investors taking responsibility should have access to that underlying portfolio. To that end, we have had very good discussions with industry groups in terms of looking at perhaps coming up with an industry standard for portfolio level disclosure. My preference is to see an industry standard develop in terms of portfolio level disclosure. I think it is actually quite important.[20]

7.53 Morningstar argued the need for greater disclosure and transparency of Australian fund managers and promoters of investment schemes, and in particular, 'comprehensive, periodic disclosure of the stocks, bonds, and other securities that make up the underlying portfolio holdings'.[21] It also noted that Australia lags behind global best practice in this area. Morningstar claimed that mandatory disclosure of portfolio holdings would:

> [A]ssist researchers, investors, financial advisers, and other market participants to detect deviation from stated investment mandates. Enhanced disclosure would also enable parties to gain a greater understanding of the characteristics and specific risks associated with the assets in which monies are being invested. The level of illiquid assets in a portfolio would also be more readily observed. Such disclosure would also provide greater

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20 Mr Greg Medcraft, Chairman, ASIC, *Committee Hansard*, Economics Legislation Committee, Estimates, 20 October 2011, p. 99.

21 Morningstar, *Submission 33*, p. 8.

> opportunity for detection of undesirable investment manager behaviours such as excessive turnover.[22]

7.54 In an answer to a question placed on notice, Mr Shawn Richard acknowledged that the establishment of the ASF as a fund of hedge funds 'may have allowed for my employers to take advantage of the lack of transparency that comes with dealing in the hedge fund industry'.[23]

Committee view

7.55 The committee believes that greater disclosure of portfolio assets would help to improve monitoring of managed investment schemes, which would in turn assist in the earlier detection of fraud. It seems likely that had the regulators and gatekeepers had information about the underlying assets of the Trio Capital funds, the significant delay in APRA's requests for information in 2009 would not have occurred.

Recommendation 9

7.56 The committee recommends that the government release a consultation paper to investigate the best mechanism for a responsible entity of a registered managed investment scheme to disclose its scheme assets at the asset level. The objective must be to enable scheme members to legally require specific information on the portfolio holdings of the registered managed investment schemes in which they have invested.

Concluding comment

7.57 The committee has recommended in this chapter a number of options to improve and to investigate the operation of the regulatory framework governing SMSFs and managed investment schemes. Some relate specifically to Trio; others relate to broader problems that the Trio collapse has exposed. The committee believes that all these recommendations warrant careful consideration. The end goal must be a system that promotes the education and understanding of retail investors and which enables the regulator and gatekeepers to monitor and detect fraud as efficiently as possible.

7.58 In addition to investigating the options for regulatory reform set out in the recommendations above, overcoming the various 'expectation gaps' will require improving investors' knowledge. Clearly, many SMSF investors in Trio Capital lacked basic knowledge of their responsibilities and the different regulatory settings between SMSF and APRA-regulated funds. As several investors have noted, the financial advice they received did not draw their attention to either the detail of their investment or the operating environment of SMSFs (see chapter 6). It is important that ASIC does

22 Morningstar, *Submission 33*, p. 8.

23 Mr Shawn Richard, *Answers to questions on notice*, received 27 April 2012, p. 1.

conduct an investigation into the exact nature of advice to SMSF investors in Trio Capital (see recommendation 7).

7.59 More broadly, the committee notes that SMSFs have been an increasingly popular investment option for Australians over the past few years. With this has come the challenge of educating these investors about their responsibilities and the risks that come with having greater control over their investment through a self-managed fund.

7.60 The committee encourages ASIC, the ATO and the various financial planning bodies to focus on providing clear, accurate and well-circulated advice to SMSF investors through publications, guidance materials and PDSs. The committee acknowledges that ASIC has produced excellent guidance material, such as its 'Investing between the flags' publication. It also launched the National Financial Literacy Strategy in March 2011. Both initiatives are to be commended. As the superannuation landscape evolves, it is vital that this information is updated and widely disseminated.