Penalties for White-Collar Crime

Submission #1

Economics Reference Committee

Terms of Reference

The inconsistencies and inadequacies of current criminal, civil and administrative penalties for corporate and financial misconduct or white-collar crime, with particular reference to:

a. evidentiary standards across various acts and instruments;
b. the use and duration of custodial sentences;
c. the use and duration of banning orders;
d. the value of fine and other monetary penalties, particularly in proportion to the amount of wrongful gains;
e. the availability and use of mechanisms to recover wrongful gains;
f. penalties used in other countries, particularly members of the Organisation for Economic Co-operation and Development [OECD]; and
g. any other relevant matters.

Recommendations

(a) the maximum penalty for the contravention of **subsection 1017C(5)** of the ***Corporations Act 2001*** be increased from a fine and two years imprisonment to a fine and ten years imprisonment

(b) a penalty be added for the contravention of **Regulation 2.33** of the ***Superannuation Industry (Supervision) Regulations 1994*** which shall be amended to allow the public access to the Deeds of any regulated superannuation fund. The maximum penalty being a fine and two years imprisonment.

(c) The failure of ***ASIC*** or ***APRA*** to enforce either of these provisions should be a reviewable decision which can be appealed to the Administrative Appeal Tribunal.

Penalties for White-Collar Crime

Introduction

White-collar crime has been defined as: "***financially motivated nonviolent crime committed by business and government professions***".

Note that white-collar crime is not restricted to the private sector.

Within criminology, the expression was first defined by sociologist Edwin Sutherland in 1939 as "***a crime committed by a person of respectability and high social status in the course of his occupation***".

The types of white-collar crime are infinite in variety, however common features are that white collar-criminals will often target those who do not have ready access to the law and will uses deception to conceal their crimes.

Where ever there are large sums of money it can be guaranteed that white-collar criminals will not be far way.

Some types of white-collar crime can be described as "*victimless*" for example "*insider trading*" on the share market where the "*insider*" has an unfair advantage over other traders because of "*inside knowledge*". However the use of this inside knowledge does not lead to the financial ruination of the other traders who do not have this insider knowledge.

Other types of white-collar crime can leave its victims financial destitute since they have lost their life savings and in some cases even their own homes.

White-collar crime can be committed by "***a person of respectability and high social status***", with the best known example being the Bernard Madoff "***ponzi scheme***" fraud.

White-collar crime can be committed by a person in a position of power, with a well known example being the **Robert Maxwell Pensions Fund Fraud** in the UK in the early 1990s where Robert Maxwell "*misappropriated*" £454 million from the pension funds of the employees of the Mirror Newspaper Group which he controlled.

Many times of white-collar crime involve complex transactions and financial deception that means the crimes are often difficult to detect and difficult to successfully prosecute.

Often the financial assets will have been sent to overseas jurisdiction beyond the reach of Australian courts and authorities.

Penalties for White-Collar Crime

The Courts have long recognised that there needs to be strong deterrent effect in the sentencing of white-collar crimes to discourage others from committing similar difficult to detect crimes.

White-collar crime associated with superannuation funds can be difficult for the members to detect since the Government does not provide any education to fund members as to their legal rights and the obligations of trustees. Dishonest trustees can use "***glossy reports***" and "***Member Handbooks***" to deceive members as to their lawful benefits.

Many funds have long histories and the consolidation of funds provides the perfect opportunity for white-collar criminals to cover-up their crimes.

The very nature of a superannuation fund makes it an ideal target for white-collar criminals since the retirement savings and entitlements of thousand of fund members are placed in the hands of a very small number of trustees or directors of a corporate trustee.

In some cases the purported trustee may not have even been lawfully appointed to the office of trustee.

White-Collar Crime in the Superannuation Industry

Since superannuation was made compulsory for working Australian by the Keating Government in 1992, the amount of funds under the control of the trustees of superannuation funds has grown dramatically and today over **$1.2 trillion** is under the control of the trustees of "***Regulated***" superannuation funds.

Australia does not have a universal superannuation scheme such as that provide by Singapore's Central Provident Fund.

Australia has a scheme where many different types of funds have come under the umbrella of a compulsory superannuation system.

The diversity of the different types of funds provides plenty of opportunity for white-collar criminals.

The benefits provided by one fund might be very different to those provided by another fund. For example one fund may provide benefits in the form of a pension which is payable immediately on retirement or retrenchment (for example the Parliamentary Fund that provided an immediate pension to the former Treasurer, the Hon Joe Hockey MP at the age of 50) whilst another may only provide a lump sum benefit payable at a prescribed early retirement age.

Where a fund pays high benefits, the employer will generally offer lower salaries compared to another employer who offers only basic superannuation benefits, given the higher employer contributions required to fund the higher benefits.

This makes it difficult for members to compare entitlements with other funds while making it easier for white-collar criminals to misrepresent the actual entitlements to members.

The trustees of superannuation funds have direct control over very large sums of "*other people's money*", that can run from the hundreds of millions to the tens of billions.

There are currently many "*loop-holes*" in the laws and regulation of superannuation funds which white-collar criminals can easily exploit.

For example it is relatively easy for an accountant of a superannuation fund to send a large sum of money from the fund to an off-shore account which he or an associate controls.

Even if caught the account may only spend a few years in prison and then retire in luxury on the proceeds which have been unable to be recovered by Australian Authorities.

An example is the case of the **Trio Capital Superannuation Fraud** where thousands lost their life savings when around $176 million was transferred to overseas accounts never to be recovered.

> For more details of this superannuation fund fraud refer to:
> http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2013/Trio%20Capital%20fraud%20review/Downloads/PDF/Trio_Capital_Fraud_Review.ashx

Yet the Shawn Richard, the co-master mind of the fraud was out of prison after two and a half years and there is no doubt he was able to access some of the funds that had been transferred to overseas accounts, with the other co-master mind, Jack Flader, who never faced the court.

By contrast Bernard Madoff, the mastermind of a major fraud in the United States that did not involve superannuation funds in a compulsory system, is now serving several life sentences (150 years) and will die in prison.

The victims of Bernard Madoff were gullible wealth people and not poor widows, whose late husband's had been forced by the Government to invest with Mr Madoff.

Clearly penalties for white-collar crimes are woefully inadequate in Australia compared to other jurisdictions.

The Deed Substitution Fraud

Most superannuation fund in Australia have been established as private trusts, although some schemes for politicians and public servants were established as statutory schemes.

Penalties for White-Collar Crime

Even though some funds were established a century ago in the context of the development of the law this is actually fairly recent.

In comparison, for centuries personal wealth has been associated with real property and the law has had many centuries to deal how to protect home owners from white-collar criminals.

The means of conveyancing of real property used in Saxon England did not require written documents but occurred at public meetings of the town folk who witnessed the agreement for the transfer of property from one party to the next.

The eminent early South Australian Legal writer, Dr Ulrich Hubbe says of this public form of conveyancing:

> "There cannot be greater eulogium passed on a nation, so proud of their individual freedoms, that of being so willing to deal only under the public eye by the direction of the law, which they themselves had freely agreed to"

The invasion of 1066 by the Normans destroyed the Saxon approach. No public notoriety attached to title transfer, with the consequence that frauds could be perpetrated with an ease which would be unlikely in a public transaction.

The Norman system developed into the common law method of property transfer.

Henry VIII conceived the **Statute of Uses** (1535) as a way of rectifying his financial problems by simplifying the law of uses, which moved land outside the royal tax revenue.

However a side effect was that the statute became a means whereby legal title could be transferred by document alone, thus allowing complete secrecy of title.

This problem had been anticipated and was sought to be avoided by the **Statute of Enrolments** (1535) which attempted to provide a register of conveyances to overcome the secrecy permitted by the **Statute of Uses.**

Under the common law property was transferred by the use of a "***Deed***" which would evidence the transfer of ownership. To ensure "*good title*" it was necessary to trace the line of ownership through a chain of deeds in theory back to when the parcel of land had been released by the Crown.

However in practice it was only required to trace the chain of Deeds back a few decades.

Under the common law system it was still easy for a white-collar criminal to draft a bonus Deed and claim ownership of a parcel of land that was not his.

To help overcome this type of fraud, a system of the Registration of Deeds was established in all States of Australia. For example, the 1826 enactment "***An Act for the registering Deed and Conveyances in New South Wales and for other purposes*** {6 Geo IV. No. 22}"

The need to register Deeds of Conveyance was greatly reduced when the system of registration of titled was adopted in Australia, initially in South Australia in 1857 (the ***Torrrens System***) and then in other States.

Superannuation Fund Deeds

Where a superannuation fund is established as a private trust, a Trust Deed will be executed to confirm the establishment of the trust. The Trust Deed will usually reserve a ***power*** to allow the terms of the trust to be amended from time to time and the legal entitlement to benefits is determined by the "***chain of deeds***" commencing from the original Trust Deed.

That is legal title to a benefit under the superannuation trust is determined by a "***chain of deeds***" not unlike the "***chain of deeds***" under common law of "***Old System***" property conveyance.

However no Government either State of Federal has mandated that the Deeds of large superannuation funds or copies of these Deeds be lodged with a public registry so they might be available for inspection by the public as are the Deeds related to real property.

Under the general laws of trusts a person who has *a beneficial interest* in a trust has a legal right to inspect the Deeds of the trust in the possession of the trustee, however the law assumes that a trustee will act honestly and inform those persons who do have a *beneficial interest* of that interest.

Since a trustee is the archetype ***fiduciary*** the law assumes a trustee will act honestly and in good faith in the execution of his or her trusts.

However these assumptions do not take into account the opportunity they present to a white-collar criminal who might gain control of the stewardship of a superannuation trust.

It is a common practice where there have been a number of Deeds of Variation to consolidate numerous amendments to the one document – a consolidation Deed of Variation so that reference need only be made to one document instead of to many.

Penalties for White-Collar Crime

However for a dishonest trustee a consolidation Deed is the perfect vehicle for fraud. For example a provision that provides a survivorship pension for widows can simply be deleted in the consolidation Deed. A Court would quickly replace the deleted provision under the doctrine of a "***Fraud on a Power***", however the fund members and widows are easily deceived if the fraudulent consolidation Deed is the only Deed provided to them.

If a widow or her solicitor asks to inspect the Deeds of the Fund, the dishonest trustee will produce the consolidation Deed and say "***Look no pension for widows***" – **now go away and do not bother us again**".

The hapless widow would not realise that she or her solicitor should have obtained a copy of the original Trust Deed that established the trust and copies of every instrument that purported to amend the terms of the original trust. These Deeds would have confirmed her pension entitlement.

Meanwhile the dishonest trustees ***live the lifestyle of the rich and famous*** on funds that had been allocated to pay the pensions of many widows.

Before superannuation became compulsory in 1992 most superannuation funds were **Defined Benefit** Funds where the assets of the fund are held in a common asset pool and benefits are based on a formula contained in the Deeds of the Fund, which general provides a benefit based on salary and years of service to the employer.

The Regulations of the fund will often also provide benefits to the spouses, the widows and widowers and dependents of the original members.

However these additional beneficiaries are reliant on the trustee(s) of the fund to advise them of their entitlement.

Most members of superannuation funds have little knowledge of their legal rights as a beneficiary of a trust or of the legal obligations of trustees.

Most simply assume that you must be able to "*trust*" a "**Trustee**". This can be an expensive mistake.

One of the consequences making superannuation compulsory was that in the late 1990s and early 2000s most **Defined Benefit** superannuation funds were closed to new members.

New employees now join **Defined Contribution** funds (Accumulation funds) where they bear investment risk and not their employer.

However many Australians now retiring or soon to retire are members of **Defined Benefit** funds and where these funds also provide benefits to widows and widowers there will still be people living over the next 50 years that will have a *beneficial interest* in these **Defined Benefit** funds.

Access to Superannuation Documents

A person who has a *beneficial interest* in a regulated superannuation fund has a statutory right to access the Deeds of the Fund has a right of access to the Deeds of his or her superannuation fund pursuant to **Section 1017C** of the ***Corporations Act 2001.***

A person who has a *beneficial interest* in a regulated superannuation fund has a statutory right to access the audited accounts and related auditor's report of his or her superannuation fund pursuant to **Section 1017C** of the ***Corporations Act 2001*** as well.

These statutory rights are derived from the general laws of trusts which provide a right to beneficiaries to have access to certain "***trust documents***".

A person who is a stranger to the trust and who has no *beneficial interest* in the trust does not have a right to have access to "***trust documents***".

Because superannuation trusts have come under government control members of the public have a right of access to a limited number of "***trust documents***" of funds in which they may have no *beneficial interest.*

A member of the public can obtain a copy of the Audited Accounts and Auditor's Report pursuant **Regulation 2.33** of the ***Superannuation Industry (Supervision) Act 1993***

However a member of the public cannot obtain copies of the Deeds of a Fund in which they have no *beneficial interest* under current statutory legislation.

This is clearly an important anomaly since members of the public can inspect the Deeds or Title Certificates of property they do not own in a public registry.

Current Penalties

Under current legislation the Parliament of Australia has made it an indictable offence for a trustee of a regulated superannuation fund to conceal the Deeds of the Fund and other prescribed documents from a person with a *beneficial interest* in the fund (ie a trustee who contravenes **subsection 1017C(5)** of the ***Corporations Act 2001***)

Under current legislation there is no penalty for the contravention of **Regulation 2.33** of the ***Superannuation Industry (Supervision) Act 1993***

However this difference creates a loop-hole that dishonest trustees exploit.

To avoid paying survivorship pensions to widows, the dishonest trustee will merely claim that the widow does not have a *beneficial interest* in the trust and so the trustee has no legal obligation to provide copies o f the very documents that will confirm the widows entitlement to a benefit.

The widow may be able to obtain copies of the audited accounts of the fund by resorting to **Regulation 2.33** however this will not confirm whether she is entitled to a benefit from the fund.

Closing the Loop-Hole

To close this loop-hole that is exploited by dishonest trustees, the Parliament must amend ***Regulation 2.33*** of the ***Superannuation Industry (Supervision) Act 1993*** to that members of the public can have access to the Deeds of any regulated fund and not just copies of the audited accounts.

Under **subsection 1017C** of the ***Corporations Act 2001*** the trustee must provide copies of the Deeds "***free-of-charge***" to a person who is a member of the fund (or a beneficiary).

The Parliament should make Deeds available to members of the public for a nominal fee such as $20 under **Regulation 2.33** of the ***Superannuation Industry (Supervision) Regulations 1994.***

With this simple amendment this will stop dishonest trustee from denying widows access to the Deeds that will confirm their pension entitlements by dishonestly claiming:

> "***You do not have a beneficial interest in this fund – so get lost"***

Trustees are under a legal obligation to act in the ***best interests*** of any person who has a *beneficial interest* in the fund.

If there is any doubt as to who has such a *beneficial interest* in the fund the trustee has a right and a duty to seek advice and directions from a court of competent jurisdiction to resolve that doubt.

The High Court of Australia in ***Macedonian Orthodox Community Church St Petka Inc v His Eminence Petar The Diocesan Bishop of Macedonian Orthodox Diocese of Australia and New Zealand***[2008] HCA 42; (2008) 237 CLR 66; (2008) 249 ALR 250; (2008) 82 ALJR 1425 provide general advice to all trustees to seek such advice if they wished to be protected from a personal liability for breach of trust.

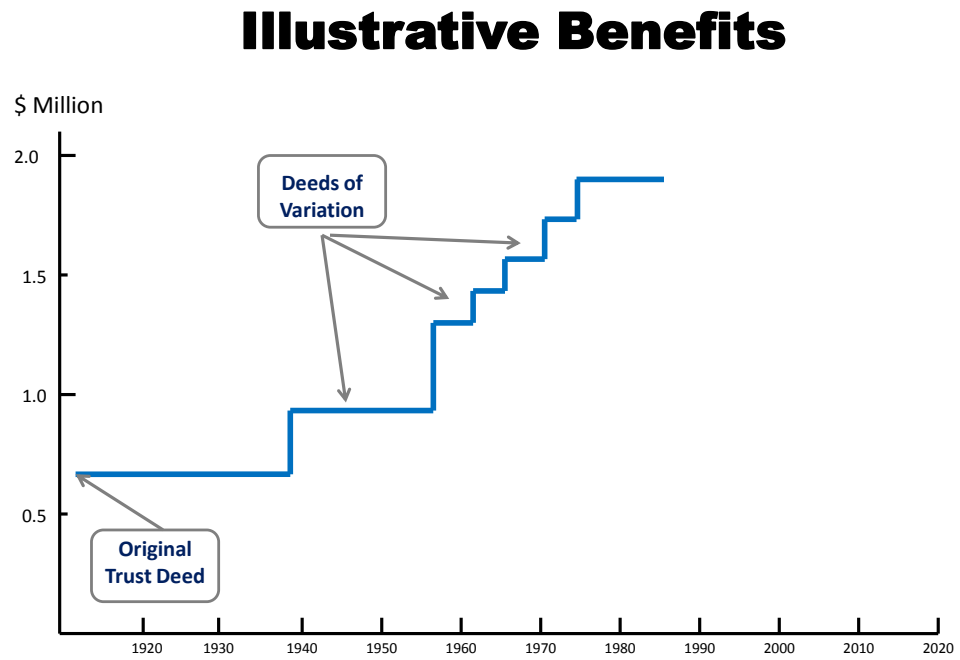
The cost of seeking such curial assistance is taken from the Trust Estate of the fund and not out of the trustee's own pocket.

If the penalty for concealing the Deeds from a person who has a *beneficial interest* in a regulated superannuation fund is increased to ten years while the penalty of concealing the Deeds from a member of the public is two years, trustees will have a major incentive to follow the advice of the High Court of Australia.

The Mechanics of a Deed Substitution Fraud

It is typical for benefits to be increased over time in line with increased member contributions as illustrated in the following diagram.

If a member or beneficiary of the fund has access to the original Trust Deed and all the Deeds of Variation that have amended the original Trust Deed this it is easy to confirm that benefits have increased over time.



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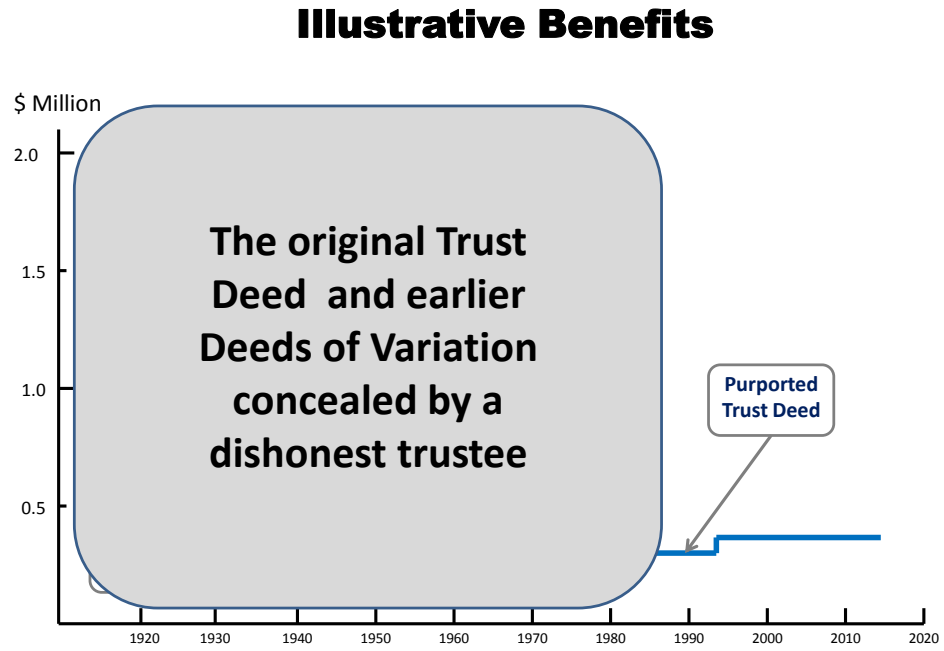
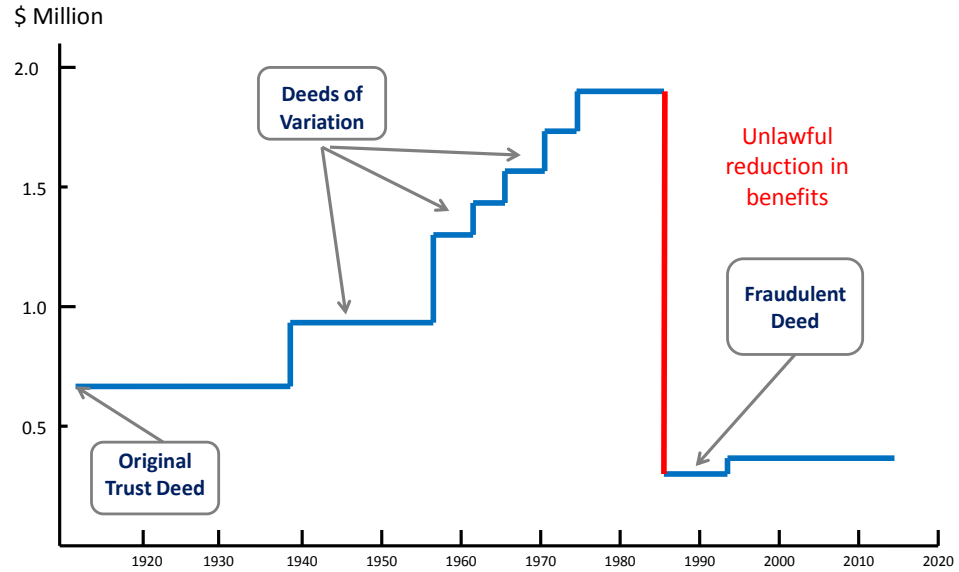
But what can happen if a dishonest trustee conceals the original Trust Deed and the genuine Deeds of Variation?



In this case the dishonest trustee represents a document that superficially looks like a genuine legal document as the "***Trust Deed***" of the fund, yet the document is entirely fraudulent.

It is only by inspecting all the Deeds of the fund that the fraud can be discovered.

Illustrative Benefits



By unlawfully reducing benefits are large actuarial surplus is created which can then be stolen using "***creative accounting***" methods to transfer moneys out of the fund.

In the book "***Creating Counting***" by Ian Griffiths {Sidgwick and Jackson} Chapter Four is titled "**How to pilfer the pension fund**".

The mechanics of a ***Deed Substitution Fraud*** are remarkably easy once a dishonest trustee has gained control of a superannuation fund and conceals the genuine Deeds from members and beneficiaries and there is even a text book available to assist dishonest trustees gain access to the members' funds.

The High Court of Australia

The High Court of Australia has noted in ***Finch v Telstra Super Pty Ltd*** [2010] HCA 36; (2010) 242 CLR 254; (2010) 271 ALR 236; (2010) 84 ALJR 726 noted at [33].

> "For some people, superannuation is their greatest asset apart from their houses; for others it is even more valuable."

The High Court continued:

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> "Superannuation is not a matter of mere bounty, or potential enjoyment of another's benefaction. It is something for which, in large measure, employees have exchanged value – their work and their contributions. It is "***deferred pay***"[1]"

The High Court stated at [35]:

> "The government considers that the taxation advantages of superannuation should not be enjoyed unless superannuation funds are operating efficiently and lawfully."

The High Court of England and Wales

Lord Neuberger, the current President of the Supreme Court of the United Kingdom stated as Neuberger J in ***Bestrustees v Stuart*** [2001] PLR 283, [2001] Pens LR 283, [2001] EWHC 549 (Ch), [2001] OPLR 341:

> "I bear in mind that a pension scheme is likely to continue for a substantial period of time and that those most affected by them and entitled to protection from the trustees, the employer and indeed the Court, will be people who are comparatively poor, who will not have easy access to expert legal advice, and who will not know what has been going on in relation to the management of the Scheme. In those circumstances, it seems to me that protection of the beneficiaries requires the Court to be very careful before it permits a departure from the plain wording and plain requirements of the trust deed."

Enforcement

Laws are not worth the paper they are written on if there is no will to enforce them.

Custodial sentence have no deterrent effect if white-collar criminal known that the "***Regulators***" will often ignore white-collar crime or at worst impose a token "***banning order***", where the white-collar criminal will be "***back in business***" after a sabbatical of three years or less.

The **Commonwealth Bank Financial Planner Scandal** is an example where the public servants at ***ASIC*** just ignored complaints of criminal conduct by Whistleblowers who revealed file tampering and other fraudulent conduct by staff of the Commonwealth Bank. To date there have been no criminal

prosecutions of any senior staff involved in the attempted cover-up and only token "***banning orders***" have been imposed on some Financial Planners who were not properly supervised by their employer.

Due to the doctrine of the ***Separation of Powers***, the Superannuation Complaints Tribunal has very limited jurisdiction. The Tribunal is unable to deal with a complaint that alleges the contravention of "***any law or governing rule***" {Refer to **Section 64** of the ***Superannuation (Resolution of Complaints) Act 1993***}.

APRA and ***ASIC*** are not "***complaint-handling agencies***" so the typical response from ***APRA*** and ***ASIC*** to a complaint about the conduct of a trustee of a regulated superannuation fund is no response at all {for example the ***Commonwealth Bank Financial Planner Scandal***}.

It is not acceptable in a compulsory superannuation system for the Australian Public Servants employed by these agencies to "***do nothing***" when trustees of regulated superannuation funds contravene superannuation laws.

If either ***ASIC*** or ***APRA*** have failed to take appropriate enforcement action within six months of receiving a complaint alleging the contravention of either **subsection 1017C(5)** of the ***Corporations Act 2001*** or the amended version of **Regulation 2.33** of the ***Superannuation Industry (Supervision) Regulations 1994*** then the deemed decision to "***take no enforcement action***" should be an appealable decision that can be appealed to the Administrative Appeals Tribunal which is a public forum where decisions must be published.

Recommendations

The recommendations to the Senate Economics Reference Committee in this submission are:

(a) the maximum penalty for the contravention of **subsection 1017C(5)** of the ***Corporations Act 2001*** be increased from a fine and two years imprisonment to a fine and ten years imprisonment

(b) a penalty be added for the contravention of **Regulation 2.33** of the ***Superannuation Industry (Supervision) Regulations 1994*** which shall be amended to allow the public access to the Deeds of any regulated superannuation fund. The maximum penalty being a fine and two years imprisonment.

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(c) The failure of ***ASIC*** or ***APRA*** to enforce either of these provisions should be a reviewable decision which can be appealed to the Administrative Appeal Tribunal.

This is what Harry Markopolos, the Bernie Madoff Whistleblower, stated before the United States Congress' House Financial Services Committee investigating the Madoff Fraud:

> ***"Government has coddled, accepted, and ignored white-collar crime for too long," he testified. "It is time the nation woke up and realized that it's not the armed robbers or drug dealers who cause the most economic harm, it's the white collar criminals living in the most expensive homes who have the most impressive resumes who harm us the most. They steal our pensions, bankrupt our companies, and destroy thousands of jobs, ruining countless lives".***

This submission to the Senate Economics Reference Committee has been submitted by Phillip Charles Sweeney on behalf of all the members and beneficiaries of regulated superannuation funds in a compulsory superannuation system who are deserving of the "***Rule of Law***" and not the "***Art of the Deal***".