Chapter 9

Concluding comments

9.1 The collapse of Trio Capital was the largest superannuation fraud in Australian history. Roughly $176 million in Australians' superannuation funds is lost or missing from two fraudulent managed investment schemes: $123 million from the Astarra Strategic Fund (ASF) and $52 million from the ARP Growth Fund.

9.2 Trio was the responsible entity for both these schemes, as well as 23 other legitimate managed investment schemes. It was also the registrable superannuation entity and common trustee of five Australian Prudential Regulation Authority (APRA) regulated superannuation funds. These funds invested heavily in the various managed investment schemes.

9.3 Significant funds from the ASF and ARP Growth Fund were invested in hedge funds in the British Virgin Islands. These hedge funds were controlled by Mr Jack Flader, one of the masterminds of the fraud. It appears that when the hedge funds collapsed, Australian investors' funds disappeared. However, it is not clear whether the principal underlying asset of the ARP Growth Fund—a derivative contract between Professional Pensions ARP Limited (PPARP) and Bear Stearns—ever existed and had value.

Compensation issues

9.4 Nearly 5400 investors in the APRA-regulated funds that invested in these schemes received full compensation under the provisions of the *Superannuation Industry (Supervision) Act 1993 (SIS Act)*. In total, the compensation package of $55 million represents the largest payout for superannuation fraud in Australia. It was financed through a (prepaid) levy on all APRA-regulated superannuation funds.

9.5 The committee views this levy as an appropriate mechanism in a compulsory tax preferred retirement savings system, where individuals rely on APRA's prudentially regulated and licensed trustees. The levy results in minimal cost to the totality of superannuation savings and is critical to maintaining ongoing confidence.

9.6 There were around 690 direct investors in the ASF who are not eligible for compensation. Of these, around 285 investors were in self managed superannuation funds (SMSFs). The SIS Act excludes SMSFs from financial assistance where certain superannuation entities have suffered loss as a result of fraudulent conduct or theft.

9.7 As this report has emphasised, the committee is extremely troubled by both the nature and the scale of these losses, and the effect they have had on hundreds of investors. The committee has received substantial evidence from Trio Capital investors detailing their considerable financial losses and the physical and emotional toll of these losses on them and their families.

9.8 However, the committee does not believe it is prudent to protect SMSF investors from losses to theft and fraud in the way that APRA-regulated superannuation fund investors are covered under the SIS Act. SMSFs are, by their nature, different to APRA-regulated funds. They are typically individuals with considerably more control over their investment strategy and portfolio than APRA-regulated superannuation fund investors. This control and choice are the key appeals of SMSFs. SMSFs also avoid the high fees and commissions that investors in the various industry superannuation funds must often pay. (A statistical summary of SMSFs found that in 2008, the average operating expense ratio of the SMSF sector was 0.69 per cent compared to 1.2 per cent for the whole superannuation industry.)[1]

9.9 These benefits of investing in SMSFs come with attendant responsibilities, one of which is to be alert to the risk or fraud and theft. Unlike APRA-regulated investors, SMSF investors do not have a professional management team to exercise this caution. As chapter 3 of this report discussed, a compensation scheme for SMSFs would in effect expose all SMSF investors to poor investment decisions and a lack of prudence by other SMSF investors. A levy on SMSFs as part of a SMSF compensation scheme could be substantial.

9.10 Nonetheless, the committee does consider there is merit to investigating a scheme that places a levy on managed investment schemes to compensate SMSFs in the event of losses by reason of fraud and theft on the part of the responsible entity. A proposal along these lines should be considered as part of the current review of compensation arrangements for consumers of financial services.

9.11 The committee recognises that this scheme, if conceived and implemented, will be too late to assist those SMSFs that have lost substantial sums in the Trio Capital collapse. However, it urges the government to investigate the possibility of compensating investors in the ARP Growth Fund. As this report has noted, these investors were induced by Mr Paul Gresham to remove their money from a Pooled Superannuation Trust—which is regulated under the SIS Act—to invest directly as a SMSF in the fraudulent ARP Growth Fund. It may be that they are eligible to receive compensation.

Pursuing the funds and the criminals

9.12 The committee also reiterates that more must be done to investigate whether the missing Trio funds can be recovered, and to pursue criminal investigations into the key figures responsible for the fraudulent overseas Trio funds. To this end, the Australian Securities and Investments Commission (ASIC) must provide all necessary funding for PPB Advisory to pursue its investigation to a full conclusion. Mr Flader's evidence must be part of this investigation. The committee also questions whether an

---

1 Australian Government, 'A statistical summary of self-managed superannuation funds', *Review into the governance, efficiency, structure and operation of Australia's superannuation system*, December 2009, p. 15.

enforceable undertaking is the only sanction that Mr Gresham deserves. It shares the surprise and disappointment of several submitters that this has been his only punishment to date.

9.13 The conduct and involvement of the Wollongong-based Mr Ross Tarrant in advising 220 of his clients to invest in the ASF was clearly different to that of Mr Gresham. Mr Gresham had had contact with the perpetrators of the fraud since at least 2003. Mr Tarrant was not aware of the fraud. Nonetheless, Mr Tarrant was paid hefty commissions by recommending Trio to his clients.

9.14 As this report proposes, the committee emphasises the need for ASIC to investigate financial planners and accountants' advice to SMSF investors in Trio Capital. The committee welcomes the imminent reform of the financial advice sector through the implementation of the Future of Financial Advice (FoFA) legislation. It notes that some of the financial advice given to Trio clients may have been in contravention of the 'best interests' test and conflicted remuneration provisions of the FoFA legislation.

The regulators

9.15 The committee is concerned that the two key regulatory agencies—ASIC and APRA—did not identify and pursue the Trio fraud until after Mr Hempton had sent his alert. Between 2004 and 2009, APRA conducted no fewer than five prudential reviews of Astarra Capital. However, these did not lead to any action. Moreover, the reviews were primarily motivated by a concern with governance related matters, rather than the events that laid the platform for the fraud to occur: the purchase of Tolhurst in 2003 and the replacement of the Trust Company as the trustee of Professional Pensions Pooled Superannuation Trust in 2004 (see chapter 2).

9.16 As chapter 4 also noted, APRA's response to Trio's inability to value the assets of the relevant funds in 2008–2009 was far too slow. The committee is critical of the apparent lack of communication between APRA and ASIC on this issue. When ASIC commenced its investigation of the hedge funds in June 2009, it did not seem aware that Trio was not providing APRA with basic facts about the existence of assets and their value.

The responsible entity and the gatekeepers

9.17 This inquiry highlights the importance of the regulatory framework governing managed investment schemes. The effectiveness and the efficiency of this framework to identify and investigate fraud, built as it is on compliance requirements and a series of gatekeepers, have been brought into question.

9.18 A key part of that system is the single responsible entity. The purpose of this single entity was to establish a single point of accountability to investors for the management of assets, instead of a system where both the manager and the trustee were accountable. Chapter 5C, subsection 601FC of the *Corporations Act 2001* establishes the duties of the responsible entity. Chapter 5C also establishes a supervisory structure of compliance plans and compliance committees to ensure that follows the rules set out in the managed investment scheme's constitution.

9.19 The strength of single responsible entity regime is its clean lines of accountability. With some notable exceptions, most submitters supported the regime primarily for this reason. However, the system can falter when the responsible entity stalls and deceives. In these circumstances, as the Trio case amply demonstrates, there are various points of systemic weakness relating to the role of the regulators, the auditors, custodians, research houses and financial advisors.

9.20 The story of Trio Capital's collapse is one of misplaced trust. Banks, acting as custodians, trusted the information they were provided by the responsible entity. The internal and external auditors also trusted the financial information given by Trio. Research houses are not required to check the underlying assets of the financial statements they rate. Financial advisers, with their limited resources, rely on the various gatekeepers to establish the veracity of the funds they recommend to clients. The clients, at the end of this chain, often lack the time, knowledge and resources to verify the worth of the funds in which they invest.

9.21 The regulators, custodians, research houses and financial planners all expressed their frustration at the inability of Trio's internal and external auditors to verify information in financial statements. The auditors cite the limitations on their role and emphasise that the primary responsibility for detecting fraud rests with the responsible entity. The committee strongly endorses ASIC's forward program to improve the rigour of compliance plans, the auditing of these plans and the composition and governance of compliance committees.

9.22 The committee also supports ASIC's work in relation to custodians. The collapse of Trio Capital has exposed the very limited role of custodians in Australia. The Trio custodians stated that they do not have the expertise to question underlying values of either domestic or offshore funds. The committee believes that ASIC should consider changing the name 'custodian' to a term such as a 'Manager's Payment Agent'.

9.23 The committee is also concerned that the reports and ratings of research houses are misunderstood by investors and give false security to investors. It is important that investors and advisers realise the limitation of custodians' role.

9.24 Improved oversight of the responsible entities of managed investment schemes by auditors, custodians and research houses is crucial. However, the committee also believes that to this end, it will assist if there is a statutory requirement for a responsible entity of a registered managed investment scheme to disclose its scheme assets at the asset level. Compared to the United States and Europe, the level of underlying portfolio disclosure of managed investment schemes in Australia is very limited. As Mr Shawn Richard noted:

> ...if a fund of hedge funds are unable to show the list of underlying assets purchased by a 3rd party manager, it will always be very difficult for all relevant parties to make the necessary checks in order to confirm whether the Australian manager is delivering on its stated strategy, risk profile and liquidity guidelines as well as detect fraud.[2]

9.25 The disclosure of specific information on portfolio holdings of managed investment schemes will improve confidence throughout the regulatory system. It will provide a greater level of assurance for internal and external auditors, custodians, research houses, the regulators, financial planners and investors themselves that the investment scheme is legitimate and well-based.

Draft legislation to improve transparency of superannuation assets

9.26 The committee is encouraged that in April 2012, the government released draft legislation which would require superannuation funds to publish on their websites details of the assets that the fund has invested in (among other matters). The draft Explanatory Memorandum states:

> Parties who invest assets of an registrable superannuation entity (RSE), or assets derived from assets of an RSE, will be required to notify the provider of the financial product that they must provide information to the RSE licensee that will allow the RSE licensee to comply with the requirement to publish portfolio holdings.[3]

9.27 The draft explanatory memorandum (EM) gives the case where a RSE licensee invests the assets of its fund through a custodian into a financial product provided by 'Managed Investment scheme 1'. Managed Investment Scheme 1 is a fund of funds, making investments into other managed investment schemes including a product offered by Managed Investment Scheme 2. The draft EM states that in this case:

- the custodian must notify Managed Investment Scheme 1 that the assets invested are those of the superannuation fund;
- Managed Investment Scheme 1 must subsequently notify Managed Investment Scheme 2 that it is investing assets derived from the assets of the superannuation funds; and
- Managed Investment Scheme 2 will have an obligation to provide information directly to ABC Super that is sufficient to identify its financial product and the value of ABC Super's investment.

---

2 Mr Shawn Richard, *Answers to questions on notice*, received 27 April 2012, p. 7.

3 Draft Explanatory Memorandum, Superannuation Legislation Amendment (Further MySuper and transparency Measures) Bill 2012, p. 28. Hhttp://strongersuper.treasury.gov.au/content/exposure_drafts/super_legislation_amendment/downloads/Explanatory-Memorandum.pdfH (accessed 27 April 2012).

9.28 The committee believes that these obligations are important. However, they deal with verifying assets between the RSE and the responsible entity of the investment scheme. As noted, it is also important that SMSF investors are protected by the responsible entity disclosing its scheme assets at the asset level to the regulators and gatekeepers.

A final note

9.29 The recommendations contained in this report are designed to enhance the responsible entity regime by improving access to, and verification of, information supplied by the responsible entity. It is of particular concern to ensure a rigorous and efficient system through which to check the presence and value of the assets of the managed investment scheme. This framework will enable fraud to be detected more readily by the regulators and the gatekeepers.

9.30 The committee believes that the recommendations contained in this report will improve understanding among retail investors of the roles and responsibilities of gatekeepers and in so doing, improve financial literacy levels. They will focus the minds of investors, regulators and gatekeepers on the need for a professional scepticism about the funds they are required to consider.

9.31 The committee views SMSFs as an important and attractive savings vehicle for those wishing to, and equipped to, exercise personal control over their retirement savings. The Trio Capital experience does not expose any significant concerns with SMSFs as a savings vehicle. There are concerns, however, with the lack of knowledge and sophistication of SMSF investors. There is a continuing need to improve their financial knowledge and understanding, and the quality of the advice that they receive.

9.32 The committee also believes that ASIC and APRA must exercise particular vigilance in their responsibilities to regulate and oversee superannuation investments and managed investment schemes investing overseas. The Australian superannuation pot is one of the largest in the world and, given the camouflage provided by the long-term nature of these investments, is potentially a ripe target for unscrupulous operators. In terms of managed investment schemes investing in overseas hedge funds, while they account for only a fraction of total Australian and overseas investments in SMSFs, they demand the regulators' full attention given their complexity and cross-jurisdictional nature.

Ms Deborah O'Neill, MP

Chair