



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND  
FINANCIAL SERVICES

**Collapse of Trio Capital**

THURSDAY, 22 SEPTEMBER 2011

CANBERRA

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**PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES**

**Thursday, 22 September 2011**

**Members in attendance:** Senators Boyce and Thistletwaite and Mr Fletcher, Mr Griffin, Mr Ripoll and Mr Smith

**Terms of reference for the inquiry:**

To inquire into and report on:

The collapse of Trio Capital and any other related matters, with particular reference to:

1. the type of investment vehicles, funds and other products involved in Trio Capital, and the relevant regulatory regime;
2. the points of failure in relation to products or advice;
3. the relationship between the SMSF arrangements and regulatory coverage;
4. the role of ASIC in monitoring Trio Capital and any subsequent pursuit of directors, advisors and fund managers;
5. the APRA regulatory relationship to Trio Capital and the use of SMSF;
6. the access to compensation and insurance for Trio Capital investors including in circumstances of fraud;
7. the issue of fraud (in particular international fraud) in the collapse of Trio Capital and regulatory implications;
8. whether there are adequate protections against fraud for those who invest through self-managed superannuation funds as opposed to other investment vehicles;
9. the appropriateness of information and advice provided to consumers, and how the interests of consumers can best be served in regulated and unregulated environments;
10. the role of ratings agencies and research organisations in product promotion and confidence; and
11. any other matters relevant to the collapse of Trio Capital in the further improvement of the financial services sector and consumer protection.

**WITNESSES**

**JOHNSTON, Mr Peter Lawrence, Executive Director, Association of Independently Owned  
Financial Planners ..... 1**

**JOHNSTON, Mr Peter Lawrence, Executive Director, Association of Independently Owned Financial Planners****Committee met at 11:41**

*Evidence was taken via teleconference—*

**CHAIRMAN (Mr Ripoll):** I declare open this public hearing of the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the collapse of Trio Capital, the fourth in a series of public hearings the committee is holding. The committee is to report by 24 November 2011.

I welcome Mr Peter Johnston here today. I remind everyone that witnesses giving evidence to the committee are protected by parliamentary privilege. Any act which may disadvantage a witness on account of their evidence is a breach of privilege and may be treated by the parliament as a contempt. It is also a contempt to give false or misleading evidence to a committee. Witnesses should be aware that, if in the giving of their evidence they make adverse comment about another individual or organisation, that individual or organisation will be made aware of the comment and given a reasonable opportunity to respond to the committee.

The committee prefers to hear evidence in public, but we may agree to take evidence confidentially if the committee believes it to be relevant to the inquiry's terms of reference. The committee may still publish confidential evidence at a later date, but we would consult the witnesses concerned before doing this.

Our first witness today, by teleconference, is Mr Peter Johnston of the Association of Independently Owned Financial Planners. Welcome, Mr Johnston. I invite you to make a short opening statement if you like, and then we can get to having some questions.

**Mr Johnston:** Sure. Astarra, as we know it, or Trio, or Absolute Alpha—which is what it was originally known as, back probably six or seven years ago—was a sponsor of ours at our conferences after it had been approved by the research houses. It was just one of many sponsors. We had it at our conferences, along with the FPA, AFA and everyone else. On the surface everything looked fine with all the research reports et cetera, but unfortunately it was not to be. Out of our 150 members, about seven were tied up with it, with clients having contributions into the unfortunate strategic fund which was previously known as Absolute Alpha. It has been a hell of a time for everyone.

**CHAIRMAN:** Thanks very much. I will just start with where you started. You said that the Astarra fund was approved by research houses. How do research houses approve funds?

**Mr Johnston:** Good question. We first came across it in 2005. A chap called Peter Wood had just been appointed head of distribution. We had known him from other product manufacturers in the past. He introduced it to us. We told him we could not have them as sponsors unless they had research house approval, which they went and got from van Eyk, Aegis and also Lonsec. The research houses apparently go through the strategy and the directors. Then they make recommendations as to whether they are suitable for consumer use. In three cases they got the tick of approval. We think the whole research industry is actually flawed—well, 90 per cent of it. When you have product manufacturers actually paying to be rated, we see that as a total conflict. The US Congress has jumped on the rating houses in the US. We think it should be done here.

**CHAIRMAN:** When did you discover this?

**Mr Johnston:** When did we discover what?

**CHAIRMAN:** That research houses are a fraud—I think you used that word.

**Mr Johnston:** No, they are conflicted.

**CHAIRMAN:** So when did you discover this?

**Mr Johnston:** This has been going on for the last 20 years. It is just part of the culture.

**CHAIRMAN:** Has it?

**Mr Johnston:** Of course.

**CHAIRMAN:** Why do you rely on them if they are conflicted?

**Mr Johnston:** Because our PI insurers insist on it and because of ASIC to some degree. They do not hold them in too high esteem, but they do ask the financial planners, 'Why did you recommend this particular product?' Unfortunately, financial planners are in the position where they are right at the end of the line. They have to rely on the regulators. They have to rely on research houses, the trustees and auditors—

**CHAIRMAN:** I am not an expert. You have been in the industry for 30 years. How do financial planners rely on ASIC? ASIC is a regulator; it does not go around approving or disapproving. What do you mean when you say financial planners rely on ASIC?

**Mr Johnston:** I think the general conception out there—I know this is not the case and I have discussed this with ASIC—is that when any PDS, product disclosure statement or what was previously known as a prospectus, is approved, in other words it has been through the regulatory process and they are licensed to offer their product to the marketplace, 99 per cent of the industry, including me with 30 years in the industry until recently, assumed that ASIC actually looked at the PDS, the directors and the business model and then, if it was all right, they would approve it. It is the industry's fault because ASIC have always said, 'We have a scant look at the PDS at best,' whereas we all assume that ASIC do look at the PDS and check out the background of the directors et cetera.

**CHAIRMAN:** You do understand the difference between a regulator approving a particular product by ticking off that it complies—that is, they have provided a PDS. ASIC are not in the business of rating, ranking, approving or otherwise giving a grade to a product or saying that a product is either in or out, good, bad or indifferent?

**Mr Johnston:** Yes, I am quite aware of that, but that is not the perception across the industry and with consumers.

**CHAIRMAN:** I understand the difference between perception and reality, but you are under a legal regulatory requirement as a professional, particularly running a business, to actually carry out your compliance obligations, not to assume or think that something may or may not be. I do not understand that.

**Mr Johnston:** What I am saying to you is that, if you surveyed the public and most of the industry, they would assume that part of the first step in the filtration process to make sure that a product actually stands up is having an approved PDS. ASIC freely say, 'We do not do it,' so I am not pointing the finger at them. All I am saying is that the perception out there is that they do it and it is not the case.

**CHAIRMAN:** I understand that. You are right that the public may have that assumption, but the public are not professionals; they are the public. Maybe even some financial planners make those assumptions, but professionals in the industry who have compliance requirements, at least those who are paid for their services, should know the difference. That is the whole point, isn't it? If nobody knows, what are you doing in the business?

**Mr Johnston:** It is funny that you say that, because I have asked many people at the top of funds management, banks et cetera, and they were under the assumption that ASIC would look at the PDS with more than just a fleeting glare. Anyway, as I said, I am not pointing the finger at ASIC; that is just the perception out in the marketplace. That is the first—

**Senator BOYCE:** I presume on that basis that you would be pleased with our recommendations that ASIC make it much clearer that the issuing of a financial services licence has nothing whatsoever to do with the probity of the product.

**Mr Johnston:** Of course, yes. I think that should be done. As I have said, they have said in the past that it is not the perception out there, so I think it is a very good idea. Yes, I do.

**CHAIRMAN:** Can we go to just the AIOFP, the association. How would you describe the association? What is it? Is it an industry association? Is it a dealer group? Is it a business? What are its core activities and how is it structured?

**Mr Johnston:** The AIOFP is a formally registered association, registered with the South Australian government. Our point of difference in the marketplace is that we are more commercially focused. We help our members and assist with commercial decisions. We have been going about 12 years. It was no use for our association to be another vanilla one such as the other ones available out there; we had to have a point of difference. So our founding objective was to further the commercial interests of our members and also their clients. For instance, if we as a group can negotiate a better fee rate on a superannuation fund or a managed fund which benefits the member and also benefits the client, that is a win-win.

**CHAIRMAN:** When you refer to clients, do you mean other financial planners?

**Mr Johnston:** No, clients of the members.

**CHAIRMAN:** If you assist with commercial decisions, do you also provide a statement of advice to meet the obligation of providing advice?

**Mr Johnston:** No.

**CHAIRMAN:** How is that possible? How can you provide advice but not provide some sort of statement? Do you take any responsibility for any assistance you provide in terms of commercial decisions or advice you give—for example, recommending Astarra?

**Mr Johnston:** No. We did not recommend Astarra. It is like any other product providers and product manufacturers, which goes with all of the associations. They allow them to come in to present to the members. The members make their own decision, and this is where the filter in the past has been the research houses approving these products. So no; we are not in the business of recommending products to our members. Like all the other associations, we allow product manufacturers who come with a high rating to present to our members, and then the members make their own decisions from there.

Our board are all licensed financial planners, and what we do is present ourselves as an aggregated force. I will give you an example: we have assisted our members to get the fee on Asgard. If you walk through the front door of Asgard, the up-front fee is about 80 basis points. Through our aggregated strength, we are able to get that down to 34 basis points, so there is a substantial saving there for the client and it gets the total cost down—the total MER of the fund, including fund manager fees et cetera on top.

**CHAIRMAN:** But I need to understand the point of difference clearly, because there is obviously a link with Astarra and Trio Capital which appears on the surface—unless you want to describe it in a different way—to be an unusually close link: Trio and a number of its people were not only sponsoring your conferences but were closely linked to the executive of AIOFP, and AIOFP were actually actively promoting that particular fund in a range of material that I have seen. So I am just wondering on what basis the AIOFP was promoting that fund and what research AIOFP did to ascertain the veracity of that particular fund—apart from research houses; I can do that myself. What does an organisation with a board and professionals do to meet its obligations in terms of recommending particular products?

**Mr Johnston:** Firstly, I do not know what documentation you are talking about. The AIOFP has never recommended any product at all. We allow product manufacturers who have the appropriate research ticks against them to present to our members at our conferences and then they make their own assessments from there. I would love to see any paperwork that you have got which states that we actually recommend them. We do not. AIOFP does not recommend anything. We allow them to present to our members at conferences. It is exactly the same as what the FPA does and the AFA and others do. So I would like to see that documentation.

**Senator THISTLETHWAITE:** Mr Johnston, there were some media reports in February 2010 that you had been active in trying to identify the location of the various tranches of missing investor funds. Is that true?

**Mr Johnston:** Yes. What had happened was that when the trouble occurred—which was in early October—two of our members in particular, Tarrants and Seagrams, had been heavily involved with Astarra in different ways. They were both directors of ours. What had happened was that there had been no further word about what was going on for about 30 days. It appeared in the paper. Stuart Washington had got hold of what had been going on and he was printing things like 'all the Astarra money's gone' et cetera. Fortunately, that was not the case. It was only the strategic fund money which was defrauded. The other two-thirds of the money was all safely sitting in normal conventional funds. Then nothing was being done and I had my two directors getting harassed by their clients—their clients were panicking; one actually ended up in hospital with a heart attack because they thought that all their money had gone but they had been in what was called the good money, instead of the bad money. It seemed no-one was doing much about it so then we started a process of trying to find out what had actually happened. We suggested that we were going to put a private investigator on to it because no-one seemed to be doing much about it. The administrator, PPB, seemed content to just stay within Australia whereas we knew the problem was offshore. So, yes, we did suggest that we would do something about it. Nothing really eventuated, because what had happened over that period, after we said it, was that then it really got the investigation going, I think, and then PPB got in on the act and then it became a bit more of a public thing.

Also then I made a time to go and see Shawn Richard to ask him exactly what was going on because we were getting conflicting messages. He then told us that he thought the money was sitting offshore. He had an audit trail which he had not handed across to ASIC. I suggested he hand that across to ASIC, which is what he eventually did. I think with our actions we actually thought we got the investigation moving along. Of particular concern was the fact that the media was saying that all the money was gone. That was all the money in the strategic fund but not the other \$300 million sitting in other normal funds. For instance, Peter Seagram is one of the groups involved up in the north of South Australia and all his clients' money was sitting in the fund which had not been defrauded. But it was getting linked to everything that Stuart Washington was saying, that all the money was gone. But he did not differentiate between the defrauded money and the safe money. We certainly became high profile on it. I personally had known Shawn like I know all the product manufacturers. There is no difference with my knowing

him as well as probably 20 others who are in similar positions to him as the head of funds management groups. I sat down with him. He proclaimed his innocence. He told me what he thought had happened and I simply stated to our members in an email that 'I don't think he was involved with the fraud', which then was leaked to the press and the whole thing blew out of control. As it works out, he has not been charged with actually defrauding the money. He has been charged with other things, secret commissions et cetera—which he has got his just desserts on. But it became a bit of a media frenzy and unfortunately Stuart Washington took a disliking to me—and vice-versa—and so he has tried every opportunity to try and shaft me whenever he has had an opportunity.

**CHAIRMAN:** Mr Johnston, can you tell us what the association's links are with Trio Capital?

**Mr Johnston:** There are no links at all. They were merely a sponsor at one of our conferences along with 20 other product manufacturers. That is all.

**CHAIRMAN:** Can you tell me about Mr Rob McGregor, who is the chair of your association, AIOFP, and was also an asset consultant to Astarra Asset Management?

**Mr Johnston:** Rob McGregor is not the chair of the AIOFP. Rob McGregor is chair of a business owned by the association called the Filtered Research Committee, which we get information through from Mercer. We only now rely on Mercer because Mercer are the only group in Australia in the research space that does not take conflicted payments from product manufacturers, which we see as a total conflict. Rob McGregor formerly worked for Astarra for eight days and he was only involved on the multi-manager business, which was the good money. The bad money was the strategic fund money, which was previously known as Absolute Alpha. Rob had nothing to do with that. He was used by Shawn Richard to put together the asset allocations for three multi-manager, which is where they pick the best fund managers from the marketplace. Rob McGregor had nothing to do with the strategic fund. He was formerly employed by Astarra for Trio—whatever you want to call it—for about eight days.

That, again, was blown out of proportion. Because we were challenging the other research houses who accept money from product manufacturers, by going with Mercer, the other groups who saw us as being a threat tried to dirty up Rob, which was totally unjustified.

**CHAIRMAN:** Do you still use those same research houses?

**Mr Johnston:** No, we do not. We uses Mercer.

**CHAIRMAN:** You said they were all same earlier. We can all use research houses, but what do you use them for?

**Mr Johnston:** You put yourself in the position of a financial planner sitting in the suburbs of the capital cities or out in the bush. They do not have the time to go around and check exactly what all the fund managers are doing around the world.

**CHAIRMAN:** But shouldn't they not recommend those products if they do not check? Isn't that the point?

**Mr Johnston:** No, it is not the point. The point is that we have financial planners who have to rely on third parties, much the same as everyone in society relies on a third party at some stage to do their work for them. It is physically impossible for a financial planner to spend the time travelling around the world checking out whether funds are investing correctly. They just do not have time to do it, so they have to rely on a third party, and one of those prominent third parties are research houses. We do not touch anyone except Mercer because all of them, all of the others above, receive conflicted payments—they are getting paid to pass judgment on products. The research houses have a pivotal role within the industry structure.

**CHAIRMAN:** How long have you known this? You said earlier about 20 years.

**Mr Johnston:** It has been going on for 20 years, yes.

**CHAIRMAN:** So why did you rely on Morningstar and others at the time for Astarra?

**Mr Johnston:** They were the only choice in the marketplace.

**CHAIRMAN:** You knew it was conflicted. You knew they were paid to provide but you still used them, and you do not use them now.

**Mr Johnston:** We had no choice. No, we do not use them now.

**CHAIRMAN:** How come you have a choice now and you did not have a choice then?

**Mr Johnston:** Because Mercer moved into the retail space. Mercer are a global concern who only dealt in wholesale arrangements with the banks. In the last 18 months Mercer have gone retail and they are the only ones in the marketplace who do not take conflicted payments. In the past, we had no choice; there was nothing else. This is where these research houses have to be jumped on, in my view. They are the gatekeepers—they sit

between the advisers and the funds management industry. The advisers need a rating to recommend the products and the product manufacturers need a rating to get the financial planners to use the product, so therefore the research houses sit in the middle.

It was clear with the Astarra situation, because I have seen the research from groups like Aegis and also Van Eyk, that they did not even bother to go offshore to check where the money was. They just took the word of the executives of Trio, which gave them information and they put the report together—and they charged them \$30,000 for it. This is one of the pivotal problems with the industry. The poor old adviser sits at the end relying on all these other third parties to do their job, and their jobs have not been done.

**CHAIRMAN:** I am confused now. Is AIOFP an industry body or a financial planning firm?

**Mr Johnston:** It is an industry body; it has never been a financial planning firm. The AIOFP has a constitution very similar to the FPA, but it is tweaked to suit the independent practices who are independent and operate their own AFSL. So we do not recommend any product, full stop. We allow them to come to our conferences like all the other associations if they in the past have had a research rating. Since this whole kerfuffle we have tightened that eligibility and now they can only come to the conference if they have Mercer rating. Therefore we know they have not paid for it.

**CHAIRMAN:** Did the association receive any payments for promoting the Astarra fund or Trio related funds?

**Mr Johnston:** Like the other associations, we charge a fee for the product manufacturers to present at our conference.

**CHAIRMAN:** Were any other fees at all received to either promote or otherwise?

**Mr Johnston:** No. Stuart Washington tried to accuse us of that. The auditors have been through the books. ASIC has been through the books. No, there is no payment at all.

**CHAIRMAN:** To the association?

**Mr Johnston:** No.

**CHAIRMAN:** Do you know if there had been any payments to members of the association?

**Mr Johnston:** Look, I cannot comment on that because I do not really know. I do not get involved with the inner workings of our members. We have got 150—

**CHAIRMAN:** There have been some, though. You know there have been some.

**Mr Johnston:** Reportedly there have, but I think there has been a bit of confusion there. Initially it was considered a secret commission at some stage, which was totally wrong. That relates to two specifically of our members. I think you will find that is not the case. I think they have been looked at very closely and it was just a media beat-up, thanks to Mr Washington trying to create a story.

**CHAIRMAN:** I understand the issue of sponsorship but I am trying to more clearly understand whether, aside from sponsorship, there was ever any payment from—

**Mr Johnston:** No.

**CHAIRMAN:** From Astarra for the manager to present at an AIOFP conference at which Astarra was the gold sponsor which was then agreed not to be disclosed because it was commercial-in-confidence?

**Mr Johnston:** You have seen that, have you? At the time we had Money Management liftout trying to make a big issue out of it and we said, 'We don't give out information about who pays what at our conferences because it is commercially sensitive.'

**CHAIRMAN:** That is the amount you are referring to, not the fact that there was a payment.

**Mr Johnston:** Yes, because it was none of their business. Two weeks after this occurred I went and saw ASIC. I told them what was going on. I told them—

**CHAIRMAN:** So there was a payment.

**Mr Johnston:** Yes, they paid us a sponsorship payment like all the other manufacturers pay us a sponsorship payment. We did not recommend them, we simply said, 'Here is a group with research ratings, they have presented at FPA, they have presented at AFA, they have presented with us.' Simple as that. Exactly the same structure as the other groups. No other payments, purely a commercial arrangement. I want to make that clear. As long as everyone is clear on that, that is good.

**CHAIRMAN:** Through emails I have seen and reports and other bits of information I have got, it appears you actively went looking for the missing funds.

**Mr Johnston:** We initially suggested we would do it. As I said before, that was—

**CHAIRMAN:** On whose behalf?

**Mr Johnston:** On behalf of our members. You may recall I told you that this whole thing hung around for about six weeks with no-one appearing to do anything except for Washington writing these ridiculous articles in the paper saying everyone's money has gone. So we suggested we would then put a private investigator on to try and find the money. Whether it is coincidence or not, then everyone started trying to do something about it. We did it as a strategy to try and get the whole investigation moving because we had people in hospital, clients of Seagram's in hospital from stress because they thought all their retirement money had gone, and it had not gone because they were in the good money. The bad money had gone.

**CHAIRMAN:** Where the money go? Did you end up finding the money?

**Mr Johnston:** No. Of course not. I had never heard of a chap called Jack Flader until this whole kerfuffle occurred. Astarra were just sponsors like we had 20 other sponsors. I happened to know Shawn Richard and the other names of the other product manufacturers' senior executives. It was just blown up by Washington to try and create a story. No, we did not find the money. As I said, we think our initiative of saying, 'We are going to try and find the money,' kind of got PBD jumping, which was good. They were the administrators, who were meant to be doing something about it. We could not see them doing anything. ASIC I think were relying on PPB to do something and nothing was being done. So we thought we would try and get a bit of a motion going, and we think it worked. Also, we assisted ASIC. You can speak to Glen Unicomb about this. We got Shawn to hand across the audit trail of where he thought the money was gone. That worked out to be correct on where the money was placed, but unfortunately the money had been defrauded at the other end somehow. As far as anything going offshore, I do not know what happened to the money. We are hoping that the Hong Kong Securities Commission is going to get to the bottom of it.

**CHAIRMAN:** At what point do you think this all went wrong in terms of the fraud of this particular fund?

**Mr Johnston:** What went wrong? Well, I do not want to point the finger at things happening, but—

**CHAIRMAN:** Please go ahead and point fingers. You have already pointed a few fingers.

**Mr Johnston:** Yes, I did mention names.

**CHAIRMAN:** Well keep pointing!

**Mr Johnston:** Okay. I am guessing because we do not get to that level. The whole financial planning industry largely relies on research to tell us this is good or bad. Whether that is flawed or not, that is just what happens.

**CHAIRMAN:** You are not going to find any research which tells you whether something is a fraud or not.

**Mr Johnston:** No, because fraud is the hardest thing to detect. There is no such thing as a bad fraudster, because they get caught; there are only good fraudsters. From my reading and from what has been going on with this inquiry—and I keep my ear to the ground with the industry to find out what is going on—it appears as though APRA should have done something about it in 2003, 2004 or 2005 asking questions about asset allocations which were never followed up. I am assuming that is the case. What happened from there? Shawn Richard was obviously conflicted with receiving secret commissions. Obviously there is this other thing which he is in jail for and deserves to be in jail for. I think where it went pear shaped is the fact that we had a very clever chap called Jack Flader sitting up in Hong Kong sending through statements saying everything was fine and these are our returns et cetera.. The research houses looked at that and said it is not a bad fund blah, blah blah, and everyone was just thinking it was nice and normal.

**CHAIRMAN:** These documents that Mr Flader was sending you, what did they look like? Were they Word documents, Excel spreadsheets?

**Mr Johnston:** No. They were not sent to us; they were sent through to Astarra Asset Management, who would then distribute them out to advisers using the fund. They were just statements saying that the fund had done X amount for the month. This was all happening in 2007-08. It was all positive returns, which I think brought suspicion about the fund because everyone else was losing money because of the GFC and this thing was going forward. Anyway, I am assuming the fraud just went over a long period of time and no-one bothered to check. This is why we ask the question: what was the trustee doing? What was the auditor doing? Three months before this whole thing occurred, the auditor signed off and said everything is fine. What does a financial planner do when they have the world-renowned auditing group KPMG saying everything looks fine?

**Mr FLETCHER:** I want to understand your assessment of what has happened here overall, as I guess you have watched it over a number of years. As a first statement, did you think you were dealing with a legitimate provider of products and subsequently discovered that in fact things were not as they seemed? Is that right?

**Mr Johnston:** Of course. I gave advice for 22 years and I personally got involved with product failure in 1984 with the Telford Property Trust and also in 1990 with the Family Security Friendly Society where I was an adviser, and our clients went through hell and I went through hell. So I have been there and I have done it twice. I can tell you now that no adviser in their right mind would pick a fund that they know it is going to fall over, because it destroys your life, which it what it has done to a number of people. So the financial planners have no choice but to rely on third parties to do their job properly. Of course, there is some due diligence the planner can do, but they have got to run a business, they have got to interview clients. They do not have the resources to go offshore and check things out. This is what we rely on the gatekeepers to do, and this, in my view, is what has let the whole thing down.

**Mr FLETCHER:** You talked about a couple of emails and one in particular that ended up in the hands of Stuart Washington in which you expressed some views about Shawn Richard, amongst other things—is that right?

**Mr Johnston:** Yes. As I stated at the time, I had known Shawn reasonably well and I went and saw him. This would have been two months after all the kerfuffle occurred. I said, 'Start from day one and tell me what happened.' He went through it. Then I sent an email saying, 'I don't think he is involved with the fraud.'

**Mr FLETCHER:** That was effectively an assessment you made at the time based on the information available to you?

**Mr Johnston:** Yes. He showed me the audit trail. He said, 'This is where the money is, I think.' I said, 'Have you given this to ASIC?' He said, 'No, they did not ask for it.' I said, 'What?' This is when I then said: 'Shawn, we have to give this to ASIC. We have to get it followed through.'

**Mr FLETCHER:** Am I right in thinking that since the time that you wrote that email you have changed your assessment of Mr Richard?

**Mr Johnston:** No, I still do not think he was involved in actually stealing the money offshore. He has been proven guilty of telling a few lies about his qualifications et cetera and also for receiving secret commissions, and he deserves to go to jail for it. But I still do not think and people very close to it with some regulators do not think that he was involved with the fraud himself.

**Mr FLETCHER:** You believe he was, in a sense, a victim of a fraud being conducted offshore?

**Mr Johnston:** Yes, I do and I think the regulators think that as well. I have actually asked them and they said: 'If we thought he was involved with fraud, he would be charged accordingly.' He has been caught for doing silly things, but he did not actually steal the money. We assume that is what Jack Flader has done. He was a beneficiary of secret commissions, which he should have disclosed and that is what he got charged for. He also told lies about his resume and his previous qualifications et cetera.

**CHAIRMAN:** Do you also believe that he did not know it was a fraud even though he did not commit the fraud?

**Mr Johnston:** No, I personally do not think he would have. Firstly, I know he put the Australian baseball superannuation fund in there, he had his own super in there and he had Peter Wood's super in there—his head of distribution and his best mate. He loved baseball. I cannot see why he would intentionally put all of that into this fund to be defrauded. That is my rational way of thinking of it. Secondly, if I had \$40 million or \$50 million hidden offshore and I was facing all the torment that he went through over the past two years, I would have gone to Darwin and jumped on a boat and disappeared into the islands somewhere. He had plenty of opportunities to do that.

**Mr FLETCHER:** Are you also putting to us that while there was a loss of money in the Astarra Strategic Fund due to fraud, you do not believe that there was fraud concerning any of the other managed investment schemes operated by Trio?

**Mr Johnston:** I do not know much about the other ones. None of our members were involved with those. Seven of the 150 were only involved with the strategic fund, which was the major problem and what affects us. None of our members were involved in the other fund, the ARP fund. I am not sure what is happening there.

**Mr FLETCHER:** How many members do you have?

**Mr Johnston:** We have 150 practices, 2½ thousand advisers and about \$40 billion of funds under administration amongst various investments.

**Mr FLETCHER:** How many of those practices put clients into the Astarra Strategic Fund?

**Mr Johnston:** Seven. Unfortunately two of them, Tarrants and Seagrims, got heavily involved with it. The other five had smaller amounts, whereas Peter Seagrim white-labelled the good money fund not the bad one but a

good fund—one of the good moneys, which in theory is a good strategy; it is good for clients and it is a good performer—but he got tainted with the whole thing—

**Mr FLETCHER:** Can I just understand one thing. As I understand it, what a financial planner will typically do is sell a wrap product, and it is through the wrap that the money then goes into a bond fund, an equities fund or something. Is that correct?

**Mr Johnston:** About 80 to 90 per cent of all inflows in the industry go into platforms, whether that is an industry fund or a government fund.

**Mr FLETCHER:** And Trio was a platform?

**Mr Johnston:** No, Trio was not a platform. Trio was the trustee, which was previously known as Astarra Asset Management, I think. So it was not a platform; it was a product manufacturer. But what it did—which is where Rob McGregor got involved in the last eight days of its history—was to put together a multimanager, which was a semiplatform. With a platform, we are talking about things like Asgard, Colonial First State, FirstChoice et cetera. So yes. What occurred there was that the strategic fund was then a product on the platform of a number of groups, including Asgard and others, and that is how the distribution occurs in the industry.

**Mr FLETCHER:** What were the arrangements between the practices that put money into the funds and Trio? What payments did the practices receive?

**Mr Johnston:** It depends on the business model of the practices. You will find even now that all products on the marketplace have provision to pay up to a certain percentage if the adviser has a business model where they accept up-front commission, which is dying; probably only 20 per cent of the market does it. So there is the up-front payment and also there is an ongoing trailing commission, which is all the stuff under this FOFA review at the moment. There is a standard payment: on every product out there, there is up to a four per cent payment. Not many take it, but there is provision there for it, because it is really a throwback from the past culture. It is the same with the trailing commissions, which can vary depending on volume.

**Mr FLETCHER:** I am interested to understand what percentages Trio was paying.

**Mr Johnston:** To be quite frank, I do not really know, because I do not get involved with the day-to-day goings-on in our members' practices. So it all gets down to negotiation. I know that in Seagram's case, because they white-labelled one of their multimanagered products—nothing to do with the defrauded moneys—he bought it from them for, say, 60 basis points and then he put 20 on top. So he sells it to his client for 80 basis points, which is a very good deal, whereas in industry funds it is normally about 100 or 120 basis points. So he thought he was doing the right thing by his clients, and it worked out that he was; unfortunately this trouble occurred. So, as it does today, it really got down to the volume and to the negotiations between the practice and also the product manufacturer. We do not get involved with that. So I do not know what they were paying.

**CHAIRMAN:** One of the key questions for us in terms of looking at this collapse is: how do you potentially prevent this happening in the future? You have outlined a number of complexities about how financial planners and advisers rely on third-party information. How would you see that working better?

**Mr Johnston:** I think we put out a paper on this; I will send it to you. This is where we think FOFA is missing the mark totally. There are two major flaws in the industry. The first one—and I have to have a go at the politicians here, of course; I am sorry about that—is that the politicians make the rules for ASIC. ASIC are a policeman and an ambulance service. They roll up to the accidents after everything has happened, they try to find out who is responsible and they try to look after the casualties, which is what they should do. We think they should be the policeman, of course; they then enforce the rules. But what we think ASIC should have a further role in is actually being part of the filtering process. In other words—

**CHAIRMAN:** So you are seeking further complex and costly regulation, which means ASIC would now be stationed in your office and would filter through every product you approve.

**Mr Johnston:** No. I have a solution that I put to one of the senior people at ASIC. They actually liked it. I will give you my view.

**CHAIRMAN:** Yes. If you could send it to the committee, we would be happy to look at it and consider whether to accept it as evidence.

**Mr Johnston:** I can tell you briefly now.

**CHAIRMAN:** Yes, that would be good.

**Mr Johnston:** We think one of the major problems with the industry is that the research houses get paid to rate products. Obviously they get sloppy, and if you pay more money you get a better rating. That is what has been going on. I will not name names but that is what has been happening for 20 years. That has got to stop

because they are a gatekeeper; they have to be controlled. We think a panel should be set up. We think every adviser in Australia should be levied a thousand dollars a head. You would have \$17 million going into a pot. It then goes out to tender to the research houses for four or five people to sit on this panel, and they get paid out of this pot. So they cannot take any conflicting—

**CHAIRMAN:** Yes, we have the idea.

**Mr Johnston:** Then what happens is that ASIC controls this process, and every PDS that comes in is referred to this committee and then they assess whether Ronald Biggs is on the board or not and they check the business model and say, 'Yes, this thing looks okay.' Then it goes to the public. Just putting it blindly up on their website, saying—

**CHAIRMAN:** Mr Johnston, we could argue the capacity of such a scheme but, unfortunately, we do not have the time. Please send it through and we will consider whether we accept it as evidence to the committee. Thanks for giving it; we appreciate it.

**Mr Johnston:** Okay, who do I send it to?

**CHAIRMAN:** Does the AIOFP have any standards or guidelines for systems that you as an association use for your membership in terms of standards that you apply so that you do not get caught up in anything riskier than normal or suspicious looking, or funds that just return too high a return against the norm?

**Mr Johnston:** Yes. We have established a business called the Filtered Research Committee. Rob McGregor is chairman of it, despite people trying to damage him over his eight days at Astarra. He is very good at what he does. He has worked for every research house in Australia. He is 60, has been around a long time and knows what he is doing. We get input from Mercer and we get input from Rob McGregor. We then sell this service on to our members. Remember that our members are also members of the FPA and every other association, so we do not have just a certain set of members. All of our members have cross-membership with all the other associations. So we say to our members: 'From now on, any product that comes to our conference has to get through Mercer. It has to be Mercer A-rated or McGregor A-rated.'

**CHAIRMAN:** Would the Astarra fund have gotten through your current process?

**Mr Johnston:** No, the strategic fund would not have.

**CHAIRMAN:** Why would it not have gone through?

**Mr Johnston:** Because Mercer would not have looked at it.

**CHAIRMAN:** Why?

**Mr Johnston:** Because Mercer are responsive to their major clients asking them to look at product, so then they charge the client to look at product. Mercer do not rely and cannot asset moneys from the product manufacturers to get a rating, so Mercer would not have looked at them at all.

**CHAIRMAN:** That only means that they could not have accepted it, but that does not mean that there was anything wrong with it.

**Mr Johnston:** No. That is the first step. Secondly, Mercer are very analytical. They are the biggest research house on earth. They would have had their analysts looking at it. The ones in Australia are Australian based and we do not think they do a very good job, to be quite frank. This is why we use Mercer. Mercer would have looked at it and said, 'We can't see where the money is invested so, no.' Mercer have very few hedge funds on their APL anyway because there is not enough disclosure on where the cash is invested.

**CHAIRMAN:** Should anyone else look to see where the money is invested, or should it just be the research houses?

**Mr Johnston:** As I said, it is impossible, impractical, for a financial planner sitting in his office in the suburbs of Sydney to suddenly jump on a plane and go across to Hong Kong every day to make sure that no one is defrauding our money. This is what we rely on other people for, in the same way that politicians rely on others. Everyone relies on third parties to do their jobs properly, and in this case it has not been done properly.

**CHAIRMAN:** But we are not talking just about individual people, though, we are talking about people who recommend products based on charging a fee and who usually work for sometimes large organisations that do have resources. Surely you do not just recommend a product in the hope or on a whim that because a research house has given it a four-star rating everything is okay? There must be more to it than that, or I am missing something. Otherwise I could just go to a newspaper and pick the top 10 with a five-star rating so why would I need to pay for advice?

**Mr Johnston:** This is one of the flaws in the system. I am not having a go at ASIC here but for a research service to be acceptable as part of an application for an AFSL you have to show a process and there are no guidelines on that process. It could be looking in the paper every day; that is a process. We do not think that is strong enough. We think there should be more rigour put around the research houses because they control the industry.

**CHAIRMAN:** Shouldn't professionals who work with research houses do their own research on the research house they use to make sure it is a good one?

**Mr Johnston:** Up until Mercer went retail with their service offering there had been no choice. They have all been in the same boat. All of them. If you think of any of the research houses out there, they have conflicted payments, which is not illegal of course, but that is what is happening out there. Until that stops you are going to have problems like this occur.

**CHAIRMAN:** Is there anything else you would like to add? The bells are ringing and we are going to run out of time. Thank you very much for what you have given us. Is there anything in particular you think is helpful to us?

**Mr Johnston:** I think it is very unfortunate that these people in SMSFs are being discriminated against.

**CHAIRMAN:** How are they discriminated against? That is interesting. You are a professional in the sector. Where is the discrimination? You do understand how a SMSF works under the law?

**Mr Johnston:** Of course. It does not mean it is not discriminatory when it comes to situations like this. If you have two clients—one who has gone directly—

**CHAIRMAN:** Yes, I understand that.

**Mr Johnston:** and one who has gone through a SMSF and that is the only investment they have got—whether they have gone through the medium of a SMSF should not make any difference. They are still in this fund which has been defrauded. They should be protected and compensated.

**CHAIRMAN:** Surely you would not advise that though. When you take on a SMSF, the first thing you need to know is what the laws and rules are of a SMSF. One of those is part 23 of the act, which makes it abundantly clear that by taking full control and as the trustee you do not need to protect against yourself as the trustee.

**Mr Johnston:** Yes, I know, but mums and dads do not read those things.

**CHAIRMAN:** No, but it is not their job. It is the job of the person advising them.

**Mr Johnston:** Possibly.

**CHAIRMAN:** It has to be somebody's job—whoever they are paying.

**Mr Johnston:** I just think in principle, whether you go through a SMSF or you have gone directly, if you have been defrauded you should be compensated. Of course we can get involved with all the nuances of this and that—

**CHAIRMAN:** It is not a nuance; it is law. It is actually written in black and white and is abundantly clear.

**Mr Johnston:** Yes, I know. I would have loved to have asked you two years ago whether you knew it.

**CHAIRMAN:** Thank you very much for your evidence. Thank you for taking the time to speak to us.

**Mr Johnston:** Okay. If you need any more, give us a yell. Thank you very much.

**Committee adjourned at 12:33**