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THE TRUST COMPANY

19 August 2011

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Dear Sir

RE: Inquiry into the collapse of Trio Capital and other related issues

The Trust Company Limited ("The Trust Company") is an ASX-listed Australian company with 125 years of financial expertise and over $93.1billion of funds under administration. We are an experienced provider of independent third party administrative and supervisory services as well as a range of trustee and custodial functions.

On 3 August 2010, The Trust Company (RE Services) Limited, a wholly-owned subsidiary of The Trust Company was appointed the replacement responsible entity of 9 registered schemes and as trustee of one wholesale trust formerly operated by Trio Capital Limited. The 10 schemes (the Trio Funds) were considered to be unimpaired in the sense that they were solvent and were going concerns. Of the 10 schemes, 3 schemes incurred impairments associated with investments in the Astarra Strategic Funds of a combined total of $11.8m (as recognised in the financial reports of the schemes for the period ended 30 June 2010).

Since becoming the responsible entity, The Trust Company has taken significant steps to stabilise and normalise the operation of the Trio Funds. These steps include:

- Incorporating the operation of the Trio Funds into an operating environment consistent with existing business provided by The Trust Company's Responsible Entity Services team. That team operates over 80 registered schemes and unregistered trusts with assets of more than $10b;
- Preparing and publishing audited financial reports for the financial year ended 30 June 2010;
- Appointing new service providers to handle auditing, registry, tax, fund administration and custody services;
- Preparing and providing unitholders annual tax statements and client statements for the financial year ended 30 June 2010;

- Maintaining a dedicated investor website (www.triofunds.com.au), providing a customer inquiry service to address unitholders' enquiries, liaising with financial advisers of clients who had invested in the Trio Funds and establishing monthly unit pricing; and

- Facilitating capital returns and redemptions of 90% of the value of seven of the Trio Funds, 70% of two funds and 53% of one fund.

The schedule attached to this letter contains The Trust Company's submissions on the issues raised by the terms of reference. The schedule is divided into 3 sections that refer to specific terms of reference. The first section goes to The Trust Company's perception of the weaknesses within the Trio Funds (terms of reference 1, 7 and 11). The second area covered relates to general concerns with the present managed investment regime (term of reference 11). The final point raises issues with the lack of recourse to gatekeepers engaged to ensure managed investment schemes are operated appropriately (terms of reference 11).

This submission has been drafted in a concise way and we would welcome the opportunity to go into further detail before the Committee at its scheduled hearings.

Yours sincerely,

John Atkin
Chief Executive Officer

Rupert Smoker
Head of Responsible Entity Services

Schedule

Observed weaknesses with the Trio Funds (Terms of reference 1, 7 and 11)

- The Trust Company observed that the former operators of the Trio Funds did not appropriately deal with conflicts of interests that emerged in their capacity as:
  - trustee of superannuation funds;
  - responsible entity of registered schemes; and
  - associates of the investment manager appointed to the Trio Funds.

  The Trio Funds were layered with a series of cross-investments between super funds and registered schemes and between separate registered schemes. These investments were ultimately managed by an investment manager (Astarra Asset Management Pty Limited), a company that was an associate of Trio Capital Limited.

  We observed little evidence to suggest that these conflicts were adequately managed with the degree of appropriate caution a reasonable fiduciary would exercise discharging their obligations. It is difficult to appreciate the motivation for these complicated cross investments. However at every level within these layered investments, fees appeared to be payable to Trio Capital.

- The proven dishonest conduct by those responsible for the investment management of the Astarra Strategic Fund coupled with the enforceable undertakings offered by the directors of Trio Capital would prima facie demonstrate a lack of robust compliance and governance arrangements within Trio Capital Limited.

- The Trust Company identified a number of issues within the Trio Funds which were reported in the Trio Funds financial statements for the period ended 30 June 2010. Those issues were:

  (a) There was a lack of evidence demonstrating that Trio Capital had effective governance, risk and compliance arrangements;

  (b) Contrary to industry practice, Trio Capital did not operate a separate bank account for the Trio Funds and instead the cash and assets of the schemes were pooled in an omnibus account held by the custodian. This method of pooling cash and assets required a lengthy and difficult reconciliation process once The Trust Company replaced Trio Capital. The pooling system adopted by Trio Capital exposed the schemes to increased risk of mistakes, misallocations and loss of control.

  (c) A number of mistakes with the calculation of distributions for past financial years.

General concerns with the managed investment scheme regime (Terms of reference 11)

- Trio Capital is another example of where the single responsible entity has compromised the interests of investors by acting in the interests of the promoter. In other words, investor protection has been compromised by the lack of independence implicit in the single responsible entity regime ushered in by the Managed Investments Act.

- Building on the failures of agribusiness MIS, the so-called safeguards built into the Managed Investments Act have again failed. In particular, the independent decision-making requirements in the single responsible entity system have been shown to be inadequate. The independent directors of a responsible entity are pitted against the resources and interests of the company that appoints them, pays them and can remove them. If a properly formed compliance committee (with external members) is in place, a majority of independent directors is not even needed. However, a compliance committee does not provide any real-time monitoring or check on the single responsible entity's actions and is similarly lacking in independence.

- The single responsible entity model is a source of, at a minimum, consternation, if not strong aversion from many overseas institutional investors, especially in the UK and Europe. Even when the scheme sponsor possesses an excellent pedigree, many institutional investors from these jurisdictions will not invest in any vehicle that does not have an independent trustee. The potential for conflict in the single responsible entity regime is perceived to be unacceptable by many foreign investors and the regime flies in the face of what is regarded as internationally accepted investment standards. Over the longer term it will manifest in less portfolio investment money coming into the Australian market. To that extent, the country will be worse off.

Gatekeeper recourse (Terms of reference 11)

- The managed investment regime contemplates a number of gatekeepers appointed by the responsible entity with specific functions designed to ensure the interests of investors in the scheme are protected. These gatekeepers include:
    - An auditor appointed to review the financial statements of a managed investment scheme;
    - An auditor appointed to review a responsible entity's compliance with the compliance plan of a scheme;
    - A compliance committee (if the board of the responsible entity is not independent) charged with a review of the responsible entity's compliance with the compliance plan.

- At present, there is uncertainty as to whether the members of a scheme have any direct rights of recourse against these gatekeepers for negligence. Any rights of

recourse are likely to be only available to the responsible entity who engages the gatekeeper. In order for these gatekeepers to ensure the highest possible standards it is an imperative that those who incur losses as a result of gatekeeper negligence are able to seek compensation for that loss. This is a particular issue for auditors.

- Claims against auditors for negligence will be limited to 10 times the engagement fee paid on commencement of the audit services by virtue of section 3 of The Accountants Scheme, which is a scheme approved under the *Professional Standards* legislation. That legislation applies to all claims, whether arising in tort, contract or under statute. The effect of the cap is such that where significant losses occur (such as those experienced with the collapse of Trio Capital), in many situations it would be uncommercial to commence a claim in negligence because the limit of the potential damages that would be available.