

19 August 2011

Mr Tim Bryant  
Committee Secretary  
Parliamentary Joint Committee on Corporations and Financial Services  
Parliament House  
Canberra ACT 2600

Dear Mr Bryant

**FSC SUBMISSION INTO THE COLLAPSE OF TRIO CAPITAL**

Thank you for the opportunity to provide this submission to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into the collapse of Trio Capital.

Please find our submission enclosed. I am available to discuss this submission should you wish. I can be contacted on 02 9299 3022.

Yours sincerely

**Andrew Bragg**  
SENIOR POLICY MANAGER

# **SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES**

## **INQUIRY INTO THE COLLAPSE OF TRIO CAPITAL AUGUST 2011**

The Financial Services Council (*FSC*) contends that the financial services industry has undergone an unprecedented level of Parliamentary, bureaucratic and independent review over the past four years. The Inquiry's Terms of Reference have already been thoroughly investigated under the following recent reviews and inquiries:

1. The Treasury Consultation into Self Managed Superannuation Funds (*SMSF*) February 2008 – not concluded;
2. The Superannuation System Review (*Cooper Review*) April 2009 - June 2010, now “Stronger Super” December 2010 - continuing;
3. The Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into Financial Products and Services in Australia of 2009 (*PJC Review*), now Future of Financial Advice (*FOFA*) April 2010 - continuing;
4. The ASIC / Treasury Review of Credit Rating Agencies and Research Houses May 2008 – November 2008, which resulted in credit rating agencies reform in 2009; and
5. Corporations and Markets Advisory Committee Review (*CAMAC*) into Managed Investment Schemes December 2010 – continuing.

Both the Cooper and previous PJC Reviews considered issues of regulatory structure and the framework / governance of financial products and services. Broadly these Reviews alone canvassed the material represented in this Review's Terms of Reference.

The Stronger Super and FOFA processes are now bedding down the government's responses to the Reviews which are designed to enhance the structure and governance of the financial services industry and deliver enhancements to consumer protection. Some reforms have already been achieved such as those dealing with credit rating agencies.

Specifically, the Terms of Reference in question have been addressed elsewhere:

- Terms 6, 7 and 8 dealing with compensation are being addressed through the Statutory Compensation Review chaired by Richard St. John;
- Terms 3 and 5 on SMSFs were considered in the Treasury SMSF Consultation and in the Cooper Review;
- Terms 2 and 9 on financial advice regulation are being addressed in the FOFA and Stronger Super reform processes – MIS specific matters are considered in the CAMAC review;
- Term 2 has partly been addressed by ASIC's review of capital requirements for Managed Investment Schemes (*MIS*);
- Term 10 dealing with credit rating agencies was addressed and the subject of reform following the ASIC / Treasury review of ratings agencies; and
- Terms 1 and 4, which are broadly regulatory structure questions, were considered during the previous PJC Review and are being addressed in the FOFA reforms.

Accordingly this is not an elongated submission. This Inquiry's Terms of Reference will be addressed in the following pages within the context that the issues raised have been addressed in the government's contemporary reform processes.

1. The type of investment vehicles, funds and other products involved in Trio Capital, and the relevant regulatory regime.

Trio Capital Limited (*Trio*) was the trustee of:

- Four Registrable Superannuation Entities (*RSEs*); and
- One Pooled Superannuation Trust (through which large amounts of SMSF funds were invested).

There were approximately 10,000 investors in the superannuation funds, 732 non-superannuation investors (primarily SMSFs invested via the Pooled Superannuation Trust).

As Registered Superannuation Entities, the above five vehicles, are governed by but not limited to the following legislative and regulatory regimes:

- *Corporations Act 2001*;
- *Superannuation Industry (Supervision) Act 1993*;
- *Superannuation Industry (Supervision) Regulations 1994*;
- *Income Tax Assessment Act 1997*; and
- Other applicable licensing requirements of APRA and ASIC.

Trio was also the Responsible Entity (*RE*) for 24 MISs including the Astarra Strategic Fund. These entities must comply with:

- *Corporations Act 2001*;
- *Managed Investment Act 1998* (now constituted in Chapter 5C of the *Corporations Act 2001*);
- *Income Tax Assessment Act 1997*; and
- And other applicable licensing requirements of APRA and ASIC.

This organisation was therefore licensed to operate both superannuation and managed investment vehicles.

2. The points of failure in relation to products or advice.

The FSC strongly believes that the majority of participants in Australia's financial services industry comply with industry standards in addition to the imposed legislative obligations and provide a valued service to their clients.

However, as previously submitted to this Parliamentary Committee, there will always be service providers whose practices are not considered consistent with those of the majority and who unfortunately fall short of legislative and industry standards.

APRA and ASIC investigated potential breaches of licence obligations connected with the collapse of Trio Capital. Recent prosecutions in respect of the collapse have considered criminal behaviour such as fraud and mismanagement relating to substantial financial losses.

The FSC submits that reforms presently in implementation as a result of the various reviews will create a simpler, more efficient regulatory framework and result in a significant strengthening of consumer protection.

3. The relationship between the SMSF arrangements and regulatory coverage.

After a comprehensive examination, the regulatory arrangements which govern SMSFs were adjudged as sound by the Cooper Review, with the need for some minor changes – according to the Review: “The SMSF sector is largely successful and well-functioning. Significant changes are not required, but measures relating to service providers, auditors and the regulatory framework are recommended.”

The government's response to the Review, Stronger Super is presently being implemented – a range of targeted changes to the SMSF framework are occurring. These are primarily in respect of auditor independence and competence, trustee penalties and treatment of collectable / personal use assets.

4. The role of ASIC in monitoring Trio Capital and any subsequent pursuit of directors, advisors and fund managers.

ASIC has broad supervisory and compliance monitoring powers under Part 3 'Investigations and Information Gathering' of the ASIC Act. For example, ASIC may use its general powers of investigation to investigate licensees "as it thinks expedient for the administration of the corporations legislation".<sup>1</sup> It may also use its information gathering powers to inspect a Licensee's financial accounts "for the purpose of ensuring compliance with the Corporations legislation".<sup>2</sup>

In addition to these extensive powers and in response to a recommendation from this Committee's Inquiry into Financial Products and Services in Australia, the government is presently considering industry submissions in response to the proposed FOFA reforms to strengthen ASIC's powers in relation to the licensing and banning of individuals from the financial services industry.

The FSC has broadly supported enhancing ASIC's powers to refuse and revoke licenses and to ban individuals from the financial services industry on that basis that:

1. ASIC believes, on reasonable grounds, that an Australian Financial Services License (AFSL) applicant is unlikely to comply with their obligations in a material respect; and
2. Enhanced banning powers are limited to cases where existing material non-compliance is evident and/or ASIC has reasonable grounds to believe that material non-compliance will occur.

If legislated, these reforms will significantly strengthen ASIC's ongoing compliance monitoring ability and provide additional powers to act pre-emptively in situations of non-compliance before consumers suffer financial loss.

5. The APRA regulatory relationship to Trio Capital and the use of SMSF.

Australia's prudential regulatory framework, which was established following the Financial System Inquiry of 1997, has been upheld as a global benchmark of financial regulatory structure.

APRA regulates Registrable Superannuation Entities (RSEs) and RSE licences under the *Superannuation Industry (Supervision) Act 1993*, *Superannuation Industry (Supervision) Regulations 2004* and the *Australian Prudential Regulation Authority Act 1998*.

A trustee of an RSE is required to hold an RSE licence. Licences bear conditions which must be met and are enforced by APRA. In late 2009, APRA utilised its powers in the following manner:

On 17 December 2009, APRA suspended Trio as the trustee of its four superannuation funds and one pooled superannuation trust, and appointed ACT Super, a subsidiary of McGrathNicol, as Acting Trustee to manage these five entities. APRA suspended Trio and appointed ACT Super as a result of numerous breaches of Trio's licence conditions and it not being able to satisfy APRA's concerns regarding the valuation of superannuation assets.<sup>3</sup>

<sup>1</sup> ASIC Act, section 13

<sup>2</sup> ASIC Act, section 28

<sup>3</sup> Australian Prudential Regulation Authority - APRA accepts enforceable undertaking from former Trio director (4/7/11) [http://www.apra.gov.au/MediaReleases/Pages/11\\_09.aspx](http://www.apra.gov.au/MediaReleases/Pages/11_09.aspx)

APRA acted on the breaches under the Act and subsequently certain directors of the organisation have been prosecuted.

Compensation to APRA-regulated superannuation fund members was then provided under the *Superannuation Industry (Supervision) Act 1993* at the direction of the Minister. Both APRA and ASIC actively investigated the organisation to determine whether fraud and mismanagement had occurred in the loss of superannuation monies.

The FSC believes the powers vested in APRA for conducting investigations and issuing directions are appropriate and sufficient. Further, the scope of APRA as Australia's prudential regulator will be widened under the government's Stronger Super package. APRA will develop a wider disclosure, efficiency and consumer-focused remit.

The additional responsibilities will extend to standardised disclosure, uniform treatment of fees and costs and the publication of enhanced performance tables.

The use of SMSFs and the forthcoming regulatory changes have been addressed under Term 2.

6. The access to compensation and insurance for Trio Capital investors including in circumstances of fraud.

The *Corporations Act 2001* requires licensees to have in place arrangements to compensate retail clients for losses they suffer as a result of a breach by the licensee or its representatives of their obligations under Chapter 7 of the *Corporations Act 2001*.

This framework seeks to reduce the risk that retail clients will go uncompensated where a licensee has insufficient financial resources to meet claims by retail clients.

The primary way for AFS licensees to comply with their legal obligation is to hold an adequate level of Professional Indemnity (PI) insurance cover. However, as previously noted by the FSC (then IFSA) in its 2009 submission to this Committee's inquiry into Financial Products and Services in Australia, a number of limitations exist within the PI insurance market including (and relevant in relation to the collapse of Trio Capital) the inability for licensees to obtain cover for fraud within the PI insurance market in Australia.<sup>4</sup>

As a result of these limitations, a comprehensive review into compensation arrangements for consumers of financial services is currently underway. As part of the FOFA reforms, the Statutory Compensation Review is occurring in response to a recommendation previously made by this Committee.

The FSC has made a number of recommendations in its submission to the Statutory Compensation Review, which if adopted by government will contribute to addressing these limitations.

In particular, the FSC has recommended improvements to the PI framework including the development of a group 'top-up' policy to cover instances where compensation is deemed appropriate but which are not generally covered or available to particular industry participants through the PI insurance market (potentially including fraud).

7. The issue of fraud (in particular international fraud) in the collapse of Trio Capital and regulatory implications.

<sup>4</sup> Previous submission - [http://www.aph.gov.au/Senate/committee/corporations\\_ctte/fps/submissions/sub317.pdf](http://www.aph.gov.au/Senate/committee/corporations_ctte/fps/submissions/sub317.pdf)

We are not in a position to comment on this matter.

8. Whether there are adequate protections against fraud for those who invest through self-managed superannuation funds as opposed to other investment vehicles.

The Assistant Treasurer, the Hon Bill Shorten MP announced that compensation for Trio investors would be provided to unit holders of the following RSE vehicles:

The assistance to the trustee, granted under Part 23 of the *Superannuation Industry (Supervision) Act 1993*, is for the Astarra Superannuation Plan, the Astarra Personal Pension Plan, the My Retirement Plan and the Employers Federation of NSW Superannuation Plan (the superannuation funds).<sup>5</sup>

As APRA regulated superannuation vehicles, compensation would be provided to the members of these financial products, which are superannuation trusts regulated as RSEs. However Trio's business consistent of registered managed investment schemes as well as superannuation trusts.

The Act provides that superannuation investors in regulated superannuation funds may be compensated in certain circumstances. This of course does not extend to managed investments schemes.

Accordingly consumers that hold units in managed investment schemes can not be compensated under Part 23 of the Act.

SMSF investors were typically investors in the managed investments offered by Trio and therefore were not members of APRA regulated funds.

A regulatory separation of superannuation funds between APRA and ATO exists as unlike all other superannuation funds, the ATO regulates SMSFs. It is only APRA regulated funds which will be subject to the compensation levy. The ATO is unable to impose a levy on SMSFs as prescribed in Part 23 of the Act.

The broader question of fraud and investor compensation is being addressed in the Statutory Compensation Review into compensation arrangements for consumers of financial services.

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.

As noted, the FOFA reforms will result in a significant change in the way consumers access financial information and advice. Of most relevance, ASIC is presently consulting on creating a new regime for regulating financial advice known as "scalable advice".

10. The role of ratings agencies and research organisations in product promotion and confidence.

The role of ratings agencies and research organisations was the subject of a May 2008 – October 2008 review by ASIC and the Treasury.

Following the Review, research houses that give financial product advice must hold an AFSL. As such, they have general obligations which include:

- (a) providing the financial service efficiently, honestly and fairly: s912A(1)(a);

<sup>5</sup> The Hon Bill Shorten MP – Financial Assistance to Trio's Superannuation Fund Investors - <http://www.dpm.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/051.htm&pageID=003&min=brs&Year=&DocType=0>

- (b) having adequate arrangements in place to manage conflicts of interest: s912A(1)(aa);
- (c) complying with the conditions on their licence: s912A(1)(b);
- (d) complying with the financial services laws: ss912A(1)(c) and (ca);
- (e) having adequate resources to provide the financial services covered by their licence and to carry out supervisory arrangements: s912A(1)(d);
- (f) maintaining the competence to provide the financial services covered by their licence (s912A(1)(e)); and
- (g) ensuring that their representatives are adequately trained and competent to provide those financial services (s912A(1)(f)).

11. Any other matters relevant to the collapse of Trio Capital in the further improvement of the financial services sector and consumer protection.
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We do not have any further comments.