Submission to the Parliamentary Inquiry into Trio Capital
By
Colin Warne, financial adviser and investor, via SMSF, in Trio Astarra

I respectfully submit my views and recommendations for consideration by the members of the Committee based on:

- my direct experience as a financial adviser
- my involvement with the Funds being investigated
- my knowledge of the impact of the failure of Trio/Astarra
- my SMSF loss of $1.2 million together with additional losses of $750,000 suffered by my partner and my two brothers

PRINCIPAL RECOMMENDATIONS

The failure of Trio Capital is an unmitigated personal disaster for many people, particularly those either in, or near retirement. It is my hope that the Committee, on completion of its inquiry, will recommend strong action by government to

1. ensure auditors do the job they're paid to do by lifting the cap on auditors' liability
2. compensate those SMSFs not eligible for the part 23 compensation
3. increase the penalties for dishonest activity by Fund Managers and their cohorts
4. review the role and responsibilities of the regulators – ASIC and APRA
5. publish more balanced and contextual information in Public Disclosure Statements

It is my strongly-held view that without significant change, what has happened in this particular instance is bound to recur. Strong, unambiguous action is required to prevent this – in particular, it is critical that ASIC fund an investigation into the auditors of the Astarra Funds. Many investors rely upon an auditor's report for reassurance about the integrity and security of their savings. When auditors fail in their responsibility, they should not escape sanction because of an artificial cap (10 times the annual fee) on their liability.

I will expand my views in respect of each of these recommendations below.

AUDITORS

At present, I am unaware of any legal action against KPMG and WHK, the auditors of the Trio/Astarra Funds. I contend that the principal reason this is so is because of the limited liability issue – viz. 10 times the annual audit fees. It is plainly uncommercial to sue.

Each auditor stated that they were satisfied that the financial statements represented a true and fair account of the financial affairs of the funds. The reality is somewhat different – we have been advised by the administrators that the true and fair financial position is virtually a 100% write-off with zero return to investors.

In other words, for six years, the funds issued audited financial statements that, arguably, were a fabrication. It appears Astarra, the responsible entity, never questioned the investment information being supplied from Hong Kong and the auditors did not, apparently, question the responsible entity.

As a consequence, it is surely reasonable to assert that the audit system lacks credibility, notwithstanding the fact that many auditors do their work diligently.

To restore confidence in the role of auditors, I submit that government must act to remove the legal liability provision.

In the meantime, I respectfully ask the Committee to make a recommendation that ASIC fund an investigation into the role of the auditors in this sorry affair and, if found wanting, that ASIC institute proceedings against the auditors.

COMPENSATION

I contend it is both unreasonable and unfair to exclude Self Managed Super Funds from the compensation provisions. The majority of individuals affected are retirees, some of whom have had their futures stolen because of dishonesty. That dishonesty was given credibility and, indeed, compounded because:

1. The responsible entity provided fraudulent financial statement, signed off as "true and correct" by the auditors, KPMG and WHK;
2. APRA reviewed the Trio/Astarra operations for six years and raised no queries – a reality that built additional credibility into the fund;
3. ASIC licensed Shawn Richard, now sentenced to imprisonment for dishonesty;
4. Research houses provided credible reports in respect of the consistency of returns and, thus, the credibility of the managers and other consultants;
5. Morningstar, a reputable organisation, rated the funds on historical investment performance, ratings which were used by Astarra to build credibility and further enhanced by auditors' failure.

With respect, I suggest to the committee that it is patently unjust for the auditors, APRA, ASIC and various research houses to suffer no penalty while retirees, after a lifetime of work, bear the brunt of a raft of failures, none of them their own.

For that reason, I appeal to the committee to make a strong recommendation for the Government to include SMSFs among those funds to be entitled to compensation as a consequence of what has occurred here. The federal government spent billions of dollars to protect jobs during the GFC – compensating investors in this instance will both go some way to restoring confidence in the superannuation industry and provide support for many retirees who now face financial difficulties at a critical time of their lives.

PENALTIES

Shawn Richard has very recently been sentenced to a minimum of two-and-a-half years jail for dishonest behaviour that led to the loss of $123 million.

By any objective view, this was a team effort and the punishment for each guilty party should be similar and, importantly, match the seriousness of the crime.

The short sentence is, in my estimation, not nearly sufficient to reflect the damage imposed on more than 5000 people.

A review of penalties for this type of criminal behaviour is warranted so as to give a message that there is a severe price to be paid.

THE REGULATORS

I have worked in the investment industry for 47 years. It is sad to state, but nevertheless true, that the vast majority of the general public have had no training in investment matters. In truth, the only assets which they understand are housing and term deposits.

Thus, for most investors, the role of the financial adviser or planner is most important. Too often, most investors are persuaded to invest in balanced funds because of the potential for higher returns. However, in a clear conflict of interest, these funds also provide the highest remuneration for investment managers and financial planners.

The investment time frame for this strategy is generally stated as five years. I believe this strategy has a much higher risk element than what is outlined in most product disclosure documents. The time frame should be 10 or more years. This reality should be brought to the attention of all investors but in particular to retirees for whom this time frame is obviously too long.

Further, the questionnaires used by financial planners to assess individual risk profiles is, in my opinion, flawed and generally designed to stream investors into growth assets.

I submit to the Inquiry that there is a more robust role to be played by the regulators to:

- ensure proper warning to investors, particularly if gearing is involved
- strictly license financial planners on the basis of demonstrated competence
- employ stronger due diligence when taking a view of auditors' statement and audited accounts.

BACKGROUND & CHRONOLOGY

I felt it would be helpful to the Committee's inquiry if I outlined the relevant chronology in respect of this matter.

1993: moved clients to ACSIS Master trust (now Trio/Astarra). This trust was owned by BDO Nelson Parkhill (accountants).

1996: ACSIS sold to Investec.

2000: Investec sold business to Tollhurst.

Dec 2003: Tollhurst sold business to WGI P/L now called Astarra.

October 2009: Astarra frozen – receivership – Trustees appointed

From 1993 to 2009, 80% of my clients' investments (mainly retirees) were managed through ACSIS – Astarra Master Trust with Funds Under Management of $150 million.

I, together with the economist in my business (Warne Financial Services), sat on the investment committee of this master trust. Our focus was to provide security & consistency in investment returns.

Why did we move to ACSIS in 1993 (now Astarra)?

The accounting firm, BDO Parkhill, was receptive to my views that to provide consistency & security for retiree investors the investment management process needed to be very active and underpinned, as far as possible, by economic forecasting & accurate asset valuations. The investment time frame was usually two years.

By way of background, the investment institutions of the world have basically followed modern portfolio theory in building portfolios. It is a theory based on risk & return with the highest delivery from equities but also with the highest level of risk. The theory has proven to be correct where investments are held for a minimum of twenty-one years. That time frame means the theory is totally inappropriate for people in retirement where security is the major consideration.

In my view, the investment institutions & financial planners are robust when it comes to promoting long-term returns but do not communicate well the risk of equity markets. Generally, they apply an investment time frame of five years but this is totally misleading. The time frame is 10 – 20 years.

Retired people, aged 60 and over, usually enjoy reasonable physical health until age 70. Between the ages of 70 and 80, health declines and from age 80 onwards most people are suffering from some serious illness and, as a consequence, lead restricted lives. To provide the level of service sought by our retired clients I felt that a high level of economic & valuation understanding was required. As a consequence, we employed our first economist in 1987 and the results speak for themselves. From 1999 to June 2004 the Tollhurst Astarra Master Trust had the following investment performance:

Pool	Net return (2003-04)	5 years' net return p.a.
Pool No 1 (Conservative)	8.75%	4.92%
Pool No. 3 (Balanced)	12.57%	5.47%
Pool No.4 (Growth)	12.69%	4.12%

These returns were approximately 1.5 % higher than the average fund manager because of active investment management.

2004-05

- I stepped down from the investment committee of Astarra because of a failed investment our company had promoted – Queen Victoria Retirement Village development. However, our economist continued as a guest of the Astarra Investment Committee.

- Shawn Richard introduced the Astarra Strategic Fund (now called the Absolute Alpha Fund). The strategy of the Fund was to be 80% fixed interest (loans to public companies), 20% equities by way of covered call strategies. The Van Eyk research company provided a report to the Astarra Investment Committee stating that this strategy would mean less risk. The Committee agreed to allocate 10% of total investment funds to a fund manager called Huntleigh in the US.

2005-06

- At the end of the first year (July 05) the Huntleigh fund's reported yield was 12.4%. The fund at this time was audited by KPMG. The Astarra Investment Committee increased the asset allocation to 20% for the four investment and superannuation pools.

- In October, Shawn Richard presented a report to the Astarra Investment Committee compiled by From Van Eyk giving performance, risk analysis of five new hedge funds under the Astarra Strategic Fund umbrella.

2006-07

- In July the fund was audited by KPMG and the Astarra Investment Committee increased the asset allocation to 30% for pools 3 and 4 of the investment and superannuation funds. The investment committee at the time requested an expansion of investment managers away from Huntleigh to provide further diversification.

- The research house Van Mac (Global Hedge Fund consultants) provided a report on the Absolute Alpha, now called Astarra Strategic Fund, giving performance and risk rating of 5 stars. (The best).

2007-08

- The research company Aegis was commissioned to do research on Alpha Strategic Fund and gave the fund a "recommended" rating.

At this time, the Astarra Strategic Fund (first called Absolute Alpha) was managed by Shawn Richard, CEO and

The investments were structured through a deferred purchase agreement between Astarra & EMA International Limited in the Virgin Islands. It appears the investment funds went from there to Hong Kong for administration. It appears that each month EMA Investment provided a report to Astarra Capital P/L advising the value of the Astarra Strategic Fund investment & total shareholdings held.

Note – There appears not to have been any breakup of the values from the various hedge fund managers. (Refer attachment)

2008-09

- In April 2009, I spoke with Richard Telfer (CFO of Astarra Capital Limited) requesting details of how the ASF unit price was established. He sent me an email (attached for the committee's information) attaching documents from Hong Kong that outlined the basis for establishing the value & unit price. He stated in this email to me that the document was very simplistic with no detail; and that they were planning a meeting between the Astarra auditors & the auditors of the ASF to get a better understanding of the investment. Shawn Richard stated to me that this meeting never occurred.

- I was concerned about the security of our investment in the ASF following the global financial crisis & Shawn Richard arranged for me to meet with Charles Provini in New York in May 2009. Provini was the asset consultant & instrumental in deal flow (loans to public companies). He assured me in person that no loans would be made to risky business.

- In June 2009, on my return to Australia, I discovered the Astarra directors had increased the asset allocation by approximately 5% to residential property for pool no 4 in the investment and superannuation sector. I challenged this as it was not in our clients' interest and was outside the investment range of the PDS. I was unsuccessful at reversing this and when ACT was appointed by APRA to be Trustee, I requested that this matter be investigated. The residential fund (Ualan) was put into receivership and we have recently been told that it is unlikely to generate any return to investors.

2010-11

- In June 2010 I reported to the acting trustee, ACT, pointing out similarities to the ASF, in that valuations were going up at between 0.6 & 0.9% every month. It appears that this fund Ualan has also been a Ponzi scheme. The acting trustee is currently investigating this matter. Once again the financials were audited by KPMG.

- In July 2011 I sent an email to the acting Trustee (ACT –) pointing out my concerns about the Ualan auditors. Nobody is willing to investigate the auditors because of the limited liability. We now have an audit process that has no credibility because of the limited liability (10 times annual audit fee) Refer copy of my email to – ACT.

Where were the auditors?

In the trial of Shawn Richard, Judge Garling's asked: "where were the auditors?"

Each year, Astarra Capital (responsible entity) generated financial reports detailing ASF annual profit return for investors. Each year, it was audited by KPMG or WHK. KPMG continued as compliance auditor when WHK became the auditor. Each firm had the responsibility of confirming the correctness of the Astarra Strategic Fund financial report.

Each audit firm, over a period of years, stated it was satisfied the financial statements represented a true and fair account of the financial affairs of ASF. The failure was continuous.

Compensation

In my view, this financial disaster will be repeated because people are easily swayed by credible, but dishonest, individuals. The results in this case: Australians who've worked hard to provide a quality lifestyle in retirement were smashed. They do not deserve this, they have earned the right to enjoy their retirement and, in my view, the government must compensate those investors not eligible for part 23 claims. (Regulated funds)

I urge the Committee to recommend that ASIC fund an investigation into the auditors of the Astarra funds. Further, the government must remove the limited liability provisions for auditors urgently. Investors rely upon auditors for the integrity & security of their savings. It is not really negotiable.

I have also enclosed a copy of a letter from the acting Trustee (ACT) to members advising them of their estimated investment balances. Note the statement about audit, it implies that, if it is audited, it will be correct. Are we entitled to believe that?

Financial Planning & Investment Managers

Broadly, most investors are persuaded to invest in balanced funds because of they are told there is potential for higher returns. But, these same funds also provide the highest remuneration for investment managers & financial planners. Thus, ever present is a conflict of interest.

The asset allocation of balanced funds is generally 60% shares, 10% property and 30% fixed interest. The investment time frame for this strategy to be effective is usually stated in the Product Disclosure Statements (PDS) as five years. This is sometimes true, but this investment strategy has a much higher level of risk than advised in the PDS. It is my strong view that the time frame should more accurately be stated as 10 years or more. Generally this is too long a period for retirees so it is reasonable to assume that, if they had been properly advised in the PDS, they would have rejected investment in a balanced fund. Such a decision would greatly reduce the risk of retirees being placed in the wrong asset allocations at a critical time of their lives.

Furthermore, the risk to investors increases greatly when economic forecasting is ignored and no consideration is given to asset valuations at the time of investing.

Part of the problem is the standard questionnaire used by financial planners to assess individual risk profiles. Frankly, it is flawed as it is designed to generate a result that pushes people into growth assets. If financial planners were better trained or advised on economic matters and had a higher level of understanding of valuation principles they could provide a very valuable service, particularly for retirees who are intent on security and consistency of returns. [Refer: article in Herald - "Return to risk (equities) may take decades says expert"]

The role of regulators

APRA in particular is highly dependent upon audited financial statements. If the auditors are negligent or not sufficiently diligent, the potential is there for investors to make decisions on false information. ASIC has recently published information stating that approximately 35% of audits were found to have inaccuracies because the auditors were not diligent enough.

It is instructive to consider that the Bernie Maddoff Ponzi Scheme ($60 billion) endured for 25 years because Maddoff's partner was his auditor.

With Trio/Astarra the audit statements gave an impression that the financial position of the Astarra Strategic Fund was sound.

On what possible basis could the auditors make such a statement when the Astarra financial controller (Richard Telfer) acknowledged that he did not know the breakup of the underlying assets [refer attached email to me April 2009]. The directors of the responsible entity did not know the details of, or correctly value, the ASF assets and, by all appearances, the auditors – whose job it was to know – did not ask.

Further, there is a need for strong warnings to investors where gearing is involved and for auditors to report total gearing levels.

It is reasonable to assert that most of the investors in the Storm Financial disaster may not have invested if they had understood both the risk associated with gearing and the risk attaching to the underlying investments (equities).

I believe the regulators need to impose a structure that requires investors to sign off acknowledging that substantial losses may occur as a result of gearing.

Summary

The Trio/Astarra financial disaster as a result of undetected fraud over 6 years has resulted in a crushing blow to investors.

The majority of these investors are retirees - people who worked hard all of their lives, paid their taxes and saved through superannuation to enable them to have a better quality of life in retirement. This has been stolen from them because of dishonesty and the dishonesty was given credibility, principally because:

1. **The responsible entity** provided

2. **The auditors**, KPMG and WHK, signed off the financial statements as true and correct.

3. **APRA** reviewed the Trio/Astarra operations for 6 years and raised no questions for five of the six years. This built credibility to the fund.

4. Shawn Richard has now been sentenced to two and a half years in prison for dishonesty.

5. **Research houses** gave highly credible reports on the ASF based on the consistency of returns and the apparent credibility of the managers . It appears the research houses were paid to provide these reports and it is difficult to believe they did anything other than duplicate the material provided to them by ASF management. Apparently, they never investigated the actual hedge fund managers to confirm the amount of funds under management and the current values.

6. **Morningstar** rated ASF and Astarra based on historical investment performance. Again this information was provided by Astarra and because of audit statements credibility is established.

7. **Financial planners** - In 1983, the Federal Government introduced rollover funds and the superannuation proceeds for retirees were now retained in the superannuation system because of the taxation incentives. Prior to this date most retirees took their funds and invested in term deposits or residential housing with a small amount going into share markets. These investments were low risk strategies.

   The financial planning industry grew rapidly from 1983 because of the huge demand for advice with very few people having any investment management skills. They put their trust in financial advisers.

   Because of the misrepresentation of investment risk (mainly equities) investors were (and still are) directed to much higher levels of risk than they understand.

Financial planners are dependent on research houses, the integrity of the responsible entity and the audit process. If this system has no credibility fraud will prosper. [Refer the attached article – meltdown exposes flaws in superannuation system.]

8. **Criminal penalties** – Shawn Richard has recently been sentenced to a minimum of two half years jail for dishonest behaviour that resulted in losses to investors of $123 million.

   The sentence imposed does not reflect the damage to 5,000+ lives.

   The government – In approximately 3 years the government is forecasting a return to surplus of $2-$4 billion. In the same way that investors in managed funds have been compensated for their loss, I feel the government should compensate SMSFs affected by the Astarra debacle. The sum involved is approximately $70 million. Compensating investors in the ASF will go a long way to restore confidence in the superannuation industry. Compensation from the government should be paid to the investors in ASF **immediately** as the majority of these people have now retired and **time for them is most important**. The past two years has already had a huge toll on many of their lives.

9. I believe strongly that Australia needs to protect people from fraud and, in particular, when our superannuation systems fail. Such guarantees are provided in Germany and Switzerland.

10. The government should fund ASIC to investigate the auditors KPMG and WHK and attempt to recover funds if negligence has occurred.

11. The government must remove the limited liability conditions associated with auditing.

This document represents approximately 1000 people whom I served as their adviser during the past 40 years and this inquiry is critical so that the flaws in our system can be corrected.

I would be most happy to appear before the Committee or, if I can be a further assistance in any other way please contact me on the number below.

Colin Warne

August 17 2011