Chapter 1

Introduction

Terms of reference

1.1 On 23 June 2011, the Parliamentary Joint Committee on Corporations and Financial Services resolved to inquire into the collapse of Trio Capital and any other related matters. In accordance with the terms of reference, in conducting the inquiry the committee had particular reference to:

(i) the type of investment vehicles, funds and other products involved in Trio Capital, and the relevant regulatory regime;

(ii) the points of failure in relation to products or advice;

(iii) the relationship between self managed superannuation fund (SMSF) arrangements and regulatory coverage;

(iv) the role of the Australian Securities and Investments Commission (ASIC) in monitoring Trio Capital and any subsequent pursuit of directors, advisors and fund managers;

(v) the Australian Prudential Regulation Authority (APRA) regulatory relationship to Trio Capital and the use of SMSFs;

(vi) the access to compensation and insurance for Trio Capital investors including in circumstances of fraud;

(vii) the issue of fraud (in particular international fraud) in the collapse of Trio Capital and regulatory implications;

(viii) whether there are adequate protections against fraud for those who invest through self-managed superannuation funds as opposed to other investment vehicles;

(ix) the appropriateness of information and advice provided to consumers, and how the interests of consumers can best be served in regulated and unregulated environments;

(x) the role of ratings agencies and research organisations in product promotion and confidence; and

(xi) any other matters relevant to the collapse of Trio Capital in the further improvement of the financial services sector and consumer protection.

Conduct of the inquiry

1.2 The inquiry was advertised in *The Australian* newspaper, *The Australian Financial Review* newspaper, in the *Business Review Weekly* magazine and *Money Magazine*. Details of the inquiry were also placed on the committee's website.

1.3 The committee invited submissions from interested organisations, government departments, and individuals affected by the Trio Capital collapse. The committee also invited prominent individuals connected with Trio Capital, including Mr Shawn Richard, to make submissions to the inquiry. The closing date for submissions was 19 August 2011, however the committee continued to accept submissions received after this date from individuals affected by the collapse. The committee received 77 submissions, 9 of which were confidential. The list of submissions is in Appendix 1.

Mr Shawn Richard

1.4 In August 2011, during the course of this inquiry, Mr Shawn Richard, a former Trio Capital director, was jailed for engaging in dishonest conduct with respect to financial services. His is the only criminal prosecution in the criminal fraud to date. While Mr Richard did not make a submission to this inquiry, the committee was interested to seek his views on a number of matters relating to the Trio fraud.

1.5 On 29 March 2012, the committee requested Mr Richard's response to a series of ten questions. It received his responses on 27 April 2012. The questions and the responses are provided in Appendix 3. Mr Richard provided the committee with additional information on 9 May 2012. This is also included in Appendix 3.

Private briefings and public hearings

1.6 The committee held private briefings with Commander Peter Sykora, Manager Crime Operations and Mr Peter Whowell, Manager Government Relations of the Australian Federal Police (AFP); Mr John Hempton and Mr Richard Butler, private capacity; and Mr Richard St John, principal for the review of statutory compensation schemes operating in the financial services sector.

1.7 The committee held seven public hearings: Sydney on 30 August 2011; Thirroul (north of Wollongong) and then in Sydney on 6 September; Sydney on 23 September 2011; Canberra on 22 September; Canberra on 4 November and Sydney on 4 April 2012. A list of witnesses who gave evidence at the public hearings and the community forum is at Appendix 2. The list does not include witnesses who gave *in camera* evidence at the community forum.

The Victims of Financial Fraud

1.8 At the public hearing on 4 April 2012, a group called the Victims of Financial Fraud (VOFF) complained that they had not had the opportunity to discuss the matter of the Trio Capital fraud with officials from APRA and ASIC. The committee resolved at the hearing that it would write to the Chairman of APRA, Mr John Laker and the Chairman of ASIC, Mr Greg Medcraft, to request that these agencies discuss the matter of the Trio Capital fraud with representatives of VOFF.

1.9 On 10 April 2012, the committee wrote to the Chairmen to request that officials from their agencies meet with VOFF representatives. At the time of writing, the parties were making arrangements to do so. APRA advised the committee that it extended an invitation to meet with representatives of VOFF on 18 April 2012 but that this offer was declined. The committee does recognise that officials from APRA and ASIC were present at the public hearing in Thirroul on 6 September 2011 when several Trio investors gave evidence. It also notes that ASIC has already met with representatives from the ARP Growth Fund.

1.10 The committee will follow up on the progress of the regulators' discussions with VOFF at the forthcoming ASIC oversight hearing in June 2012, and (for APRA) through the Senate Estimates process.

Acknowledgement

1.11 The committee thanks those organisations and individuals that made written submissions, and those who assisted the committee through attending private briefings or by presenting evidence at public hearings or at the community forum.

1.12 In conducting the inquiry, the committee was particularly interested in the implications of the Trio Capital collapse for investors, especially investors in self-managed superannuation funds. The committee recognises the trauma experienced by investors affected by the Trio Capital collapse, and is grateful for the assistance that investors provided through sharing their stories and experiences with the committee.

1.13 Through the public hearings and the community forum, the committee sought to hear from a balanced selection of investors, advisers, regulators and individuals. Nevertheless, the committee acknowledges that there were individuals who wished to provide evidence, particularly at the community forum, but did not receive the opportunity to do so. The committee thanks these people for their willingness to assist the committee.

Privilege issue

1.14 During the course of the inquiry, a witness who presented evidence *in camera* drew the committee's attention to what appeared to be a widely distributed email, authored by a financial advisor, which strongly criticised the witness for providing evidence to the committee. The committee drew the financial advisor's attention to the protections afforded to witnesses under the Parliamentary Privileges resolutions, and informed the advisor that the committee would consider taking further action should the advisor continue with this or similar conduct. No further conduct was brought to the committee's attention.

Scope of the inquiry

1.15 While information about the experiences of persons directly affected by the collapse of Trio Capital greatly assisted the committee, the committee does not have the power to take action in individual cases. The committee's inquiry sought to determine whether improvements can be made to Australia's financial services sector and consumer protection regulations. While some of the committee's recommendations focus on pursuing the lost Trio funds and bringing those illegally involved with the scheme to justice, most of the recommendations address the broader issues of the transparency of the superannuation investment framework.

Cooper Superannuation Review

1.16 This inquiry occurs in the context of broader reforms to the Australian superannuation system arising from a 2010 review of the system chaired by Mr Jeremy Cooper.[1] The Cooper Review formulated ten guiding principles for developing superannuation policy. These included:

- recognising the importance of regulation in addressing prudential and other risks;
- the key objectives of transparency and disclosure to the operation of the system;
- providing members with choice, while recognising that greater choice entails greater responsibility; and
- ensuring that the superannuation system is supported by high quality research and data, as well as by intermediaries with high professional standards.

1.17 The Cooper Review's recommendations drew from these guiding principles.

1.18 Some of the Cooper Review's recommendations related to the SMSF sector, although these were 'not dramatic and largely relate[d] to compliance, audit, adviser competency and like measures'.[2] Among other matters, the Review recommended that SMSF trustees be prohibited from acquiring collectables and personal use assets, to ensure that all investments were made for genuine retirement income purposes.[3]

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1 Super System Review Panel, *Final Report*, 30 June 2010, Hhttp://www.supersystemreview.gov.au/content/content.aspx?doc=html/final_report.htmH (accessed 1 May 2012).

2 Super System Review Panel, *Final Report*, 30 June 2010, p. 16, Hhttp://www.supersystemreview.gov.au/content/content.aspx?doc=html/final_report.htmH (accessed 1 May 2012).

3 Super System Review Panel, *Final Report*, 30 June 2010, p. 247, Hhttp://www.supersystemreview.gov.au/content/content.aspx?doc=html/final_report.htmH (accessed 1 May 2012).

1.19 The Government did not implement this recommendation. Rather, through the *Superannuation Industry (Supervision) Amendment Regulations 2011 (No. 2)*, SMSF trustee investments in artwork, jewellery, antiques, artefacts, coins and a range of other collectables cannot be leased to, used by or stored in the private residence of a related party to the trustee of the SMSF, and any decision to store such investments must be accompanied by written reasons. These regulations came into effect on 1 July 2011, although they allowed SMSFs with existing assets a five year transitional period within which to comply.

Other related inquiries

1.20 In 2009, the committee conducted an inquiry into financial products and services. The inquiry was initiated in response to the collapse of a number of high profile financial product and service providers including Storm Financial and Opes Prime. The focus of this inquiry was on the role of financial advisers and their commission arrangements for financial product sales and advice.[4]

1.21 The inquiry catalysed the announcement of the Future of Financial Advice (FOFA) reforms in April 2010 to 'improve the trust and confidence of Australian retail investors in the financial planning sector'.[5] The FOFA reforms consisted of an eighteen month consultation period culminating with two bills,[6] the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011.[7] The bills were examined by the committee and the Senate Economics Legislation Committee which reported in February and March 2012 respectively.

1.22 The FOFA reforms adopted many of the recommendations made by the committee in its 2009 inquiry into financial products and services and also proposed several additional measures. The bills, which are currently before parliament, propose to amend the *Corporations Act 2001* to:

- place a requirement on providers of financial advice to obtain client agreement for ongoing advice fees every two years and to provide clients with enhanced annual disclosure fee statements;

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4 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. vii.

5 The Hon. Chris Bowen MP, (former) Minister for Financial Services, Superannuation and Corporate Law, 'Overhaul of Financial Advice', *Media Release No. 036*, 26 April 2010.

6 The Senate Economics Legislation Committee, 'Inquiry into the Corporations Amendment (Future of Financial Advice) Bill 2011 [Provisions] and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 [Provisions]', March 2012, p. 7.

7 The Corporations Amendment (Future of Financial Advice) Bill 2011 was introduced into the House of Representatives on 13 October 2011; the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 was introduced into the House of Representatives on 24 November 2011.

- enlist changes to ASIC's licensing and banning powers, including the expansion of discretionary powers relating to individuals;
- impose a best interests duty on financial advisers when they interact with clients;
- ban the receipt of remuneration which could reasonably be expected to influence the financial advice provided to clients;
- ban the charging of asset-based fees on borrowed monies of clients (fees calculated as a percentage of client funds under advice); and
- ban volume-based shelf-space fees paid from fund managers to administration platform operators.[8]

1.23 The government responded to concerns raised by industry that the proposed commencement date for the bills did not allow for adequate implementation time as well as arguments that the FOFA reforms should commence in alignment with the Stronger Super reforms. The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation announced in March 2012 that '[t]he reforms will commence from 1 July 2012, as originally announced, but the application of the provisions will be voluntary until 1 July 2013'.[9]

1.24 As part of the initial FOFA reforms announcement, the Government also commissioned Mr Richard St. John to review the need for, and costs and benefits of, a statutory compensation scheme for investors. This review was in response to recommendation 10 of the committee's 2009 inquiry. The closing date for submissions to the consultation paper for the review was 1 June 2011 and 28 submissions were received.[10]

1.25 Mr St John's review, which concluded in April 2012, examined the adequacy of arrangements by which investors may be compensated where they suffer loss as a result of misconduct by a financial services provider. The particular focus was on the position of retail clients who incur financial loss or damage as a result of a breach of a financial service licensee under Chapter 7 of the Corporations Act.

1.26 Chapter 3 of this report looks at the findings of the Richard St John review.

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8 The Senate Economics Legislation Committee, Inquiry into the Corporations Amendment (Future of Financial Advice) Bill 2011 [Provisions] and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 [Provisions], March 2012, p. 2.

9 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, 'Smoother transition for financial advice reforms', *Media Release No. 013*, 14 March 2012.

10 Treasury, 'Future of Financial Advice: Review of compensation arrangements for consumers and financial services – Consultation Paper', Hhttp://futureofadvice.treasury.gov.au/content/Content.aspx?doc=consultation/compensation_arrangements_CP/default.htmH (accessed 21 March 2012).

The role of APRA in relation to superannuation

1.27 As part of its broad prudential role, APRA is responsible for the prudential supervision of superannuation funds (excluding self-managed funds). APRA oversees the compliance of registrable superannuation entities (RSE) with the *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act), as well as administering the licensing of RSEs. The licensing regime requires the trustees of superannuation funds that are not self-managed funds to obtain an RSE license before they can operate as a trustee of a superannuation fund.[11]

1.28 In order to obtain an RSE license, the trustee must comply with certain conditions, including meeting minimum standards of fitness and propriety and maintaining risk management strategies governing the trustee's operations and risk management plans for each fund under the trustee's control.[12]

1.29 APRA summed up its role in supervising RSEs in its submission to the committee:

> APRA's supervisory approach is based on the fundamental premise that the primary responsibility for financial soundness and prudent risk management within a superannuation fund rests with its board of directors and senior management. Our approach, therefore, is to attempt to work with these parties to resolve any issues and ensure that fund member interests are protected. APRA's role is to promote prudent behaviour by superannuation funds through a robust prudential framework of legislation and prudential guidance which aims to ensure that risk-taking is conducted within reasonable bounds and that risks are clearly identified and well managed.[13]

Registrable Superannuation Entities

1.30 As set out above, a trustee must obtain an RSE license before it is able to operate as the trustee of a superannuation fund. APRA maintains a register of all RSEs and RSE licensees. The trustee of an RSE (or of an RSE licensee) is required to:

(a) comply with the fund's governing rules and the SIS Act, which includes obligations to: act honestly in all matters concerning the superannuation entity; exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with property of another for whom the person felt

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11 APRA, *Superannuation*, Hhttp://www.apra.gov.au/Super/Pages/default.aspxH (accessed 1 May 2012).

12 ASIC, *How do the RSE and AFS licensing application processes work together?*, 31 March 2011, Hhttp://www.asic.gov.au/asic/asic.nsf/byheadline/How+do+the+RSE+and+AFS+licensing+application+processes+work+together%3F?openDocumentH (accessed 1 May 2012).

13 APRA, *Submission 41*, p. 5.

morally bound to provide; and ensure that the trustee's duties and powers are performed and exercised in the best interests of the beneficiaries);

(b) comply with the prudential requirements set out in its RSE licence;

(c) comply with its risk management strategies and plans;

(d) maintain adequate financial, technical and human resources to operate as a trustee under the SIS Act;

(e) maintain minimum standards of fitness and propriety for superannuation fund trustees;

(f) comply with a risk management strategy which is specific to the trustee and specific for any RSE for which the trustee acts in the capacity of trustee; and

(g) ensure that any outsourcing arrangements are conducted under proper and enforceable agreements.[14]

1.31 APRA periodically reviews RSEs for their compliance with their RSE license conditions, including compliance with the trustee's risk management strategy and plan.[15] Under section 29G of the SIS Act, APRA may cancel an RSE license if the licensee has breached a condition of its license.

1.32 It is important to note that an RSE license is different to, and separate from, an Australian Financial Services License (AFSL). While they share some common requirements, and an entity may be required to hold both in order to operate a superannuation fund, the focus of the two licenses is different.

1.33 An RSE license is a license to operate a superannuation fund. As outlined above, in assessing an application, APRA focuses on prudential standards, the fitness and propriety for office of the superannuation fund's trustees (and, if they are bodies corporate, their directors) and the operations, systems and resources (including risk management systems and financial resources) of the trustee to prevent or minimise loss.[16]

1.34 An AFSL, on the other hand, is a license, issued by ASIC, to operate a financial services business. A financial services business could include providing financial product advice or dealing in financial products such as interests in superannuation funds. ASIC focuses on consumer protection and market integrity. It

14 ASIC, *Submission 51*, p. 96.

15 ASIC, *Submission 51*, p. 97.

16 ASIC, *How do the RSE and AFS licensing application processes work together?*, 31 March 2011, Hhttp://www.asic.gov.au/asic/asic.nsf/byheadline/How+do+the+RSE+and+AFS+licensing+application+processes+work+together%3F?openDocumentH (accessed 1 May 2012).

assesses the ability of an entity, including its responsible managers, to provide efficient, honest, fair and competent financial services. ASIC also looks at the entity's compliance measures and client complaint handling procedures.[17]

The role of the responsible entity

1.35 Trio Capital was the 'responsible entity' for several managed investment schemes, which it used to invest superannuation funds for which it was the trustee. It is important to understand the legal obligations of the responsible entity of the managed investment schemes.

1.36 The *Managed Investments Act 1998*[18] introduced the concept of the responsible entity as a single point of accountability. This replaced the Prescribed Interests regime (part 7.12 of the former corporations law) where both the manager and the trustee were accountable.[19] The primary purpose of the 1998 reforms was to ensure that only one entity would be responsible to investors for the management of assets held under managed investment schemes.[20]

1.37 Under section 601FB of the Corporations Act, the responsible entity is liable for the operation of the scheme, in accordance with the scheme's constitution and the Corporations Act. Under section 601FC of the Corporations Act, the responsible entity's duties include the obligation to act honestly; to act in the best interest of members; to ensure all payments out of scheme property are made in accordance with the scheme's constitution; and to ensure the scheme property is valued at regular intervals appropriate to the nature of the property.[21]

1.38 The regulation of the responsible entity is the responsibility of ASIC. The managed investment scheme, including the name of the proposed responsible entity, must be registered with ASIC in certain circumstances, including where it has more than 20 members or where it was promoted by a person in the business of promoting such schemes.[22]

1.39 As noted above, ASIC has responsibility under the Corporations Act to grant and monitor AFSLs. Holding an AFSL is a pre-requisite for operating as a responsible entity. Under the Corporations Act, an AFSL holder must:

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17 ASIC, *How do the RSE and AFS licensing application processes work together?*, 31 March 2011, Hhttp://www.asic.gov.au/asic/asic.nsf/byheadline/How+do+the+RSE+and+AFS+licensing+application+processes+work+together%3F?openDocumentH (accessed 1 May 2012).

18 now Chapter 5C of the *Corporations Act 2001*

19 ANZ, *Submission 70*, p. 3.

20 ANZ, *Submission 70*, p. 3.

21 Corporations Act 2001, section 601FC, chapter 5C

22 Corporations Act 2001, section 601ED, chapter 5C

> (a) comply with conditions on their licence and the financial services laws;
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> (b) provide financial services efficiently, honestly and fairly;
>
> (c) have adequate arrangements to manage conflicts of interest;
>
> (d) ensure representatives are adequately trained and competent, and comply with the law;
>
> (e) have adequate resources (including financial, technological and human resources) to provide the financial services covered by their licence and to carry out supervisory arrangements;
>
> (f) maintain the licensee's own competence, skills and experience;
>
> (g) maintain internal and external dispute resolution systems where clients are retail consumers;
>
> (h) maintain adequate risk management systems;
>
> (i) properly handle client money (trust account and audit requirements);
>
> (j) notify ASIC of significant breaches;
>
> (k) have adequate arrangements to compensate retail clients for losses; and
>
> (l) provide key disclosure documents.[23]

1.40 Chapter 5C of the Corporations Act anticipates that a responsible entity might not follow the rules set out in the managed investment scheme's constitution or the laws governing managed investment schemes. This part of the Act is summarised by ASIC in its submission:

> There are three mechanisms in Ch 5C to deal with the perceived compliance risk in a cost effective way. These are the requirements for:
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> (a) each registered managed investment scheme to have a compliance plan setting out adequate measures for the responsible entity to apply to ensure the managed investment scheme complies with its legal obligations (s601HA);
>
> (b) the compliance plan to be audited annually by a registered company auditor or audit firm (s601HG); and
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> (c) a compliance committee to be established where less than half of the directors of the responsible entity are external directors (s601JA).[24]

1.41 ASIC's submission commented on these three requirements. In terms of (a) (above):

> A compliance plan is a document designed to set out the various checks and balances to be established to ensure that a registered managed investment scheme operates in accordance with the requirements of its constitution and the Corporations Act. The Corporations Act does not specify what

23 ASIC, *Submission 51*, p. 113.

24 ASIC, *Submission 51*, p. 35.

> constitutes adequate checks and balances, with the intention being that the responsible entity develop and implement an appropriate set of compliance measures to address a minimum number of mandatory risks. The approach was intended to provide flexibility for responsible entities to create compliance measures that were tailored for the particular registered managed investment scheme.[25]

1.42 In terms of the annual audit of the compliance plan ((b) above), ASIC noted:

> The requirement to appoint a compliance plan auditor who audits the compliance plan annually operates as an independent external oversight of the responsible entity's compliance arrangements. The purpose of requiring an audit of the compliance plan is to ensure the compliance plan is current at all times.[26]

1.43 In terms of the purpose of the compliance committee ((c) above), ASIC explained:

> The compliance committee is intended to act as an intermediary between the operational compliance unit and board of directors in relation to compliance monitoring, assessment and reporting. Given ASIC's finite resources, the compliance committee also plays an important role as 'gatekeeper'.[27]

1.44 The committee recognises that these arrangements are designed to provide a strong governance framework for the managed funds that help the operators demonstrate probity and assist them to manage conflicts of interest. However, it has received considerable evidence that there are weaknesses in this framework. These issues are discussed in some detail in chapter 7 of this report.

Dual regulated entities

1.45 As chapter 2 discusses, Trio Capital was both a licensed superannuation fund trustee and the responsible entity for several managed investment schemes. ASIC noted in its submission that there are approximately 33 entities that hold both an AFSL to operate as a responsible entity and a RSE licence to operate as a registrable superannuation entity. These dual regulated entities are subject to oversight by both ASIC and APRA.

1.46 ASIC explained that there are two key differences in the obligations under the Corporations Act for dual regulated entities. Dual regulated entities are excluded by the Corporations Act from the obligations to have adequate resources (s912A(1)(d)) and adequate risk management systems (s912A(1)(h)). These exemptions are on the basis that dual entities are regulated under the SIS Act by APRA 'and it would be

25 ASIC, *Submission 51*, p. 36.

26 ASIC, *Submission 51*, p. 38.

27 ASIC, *Submission 51*, p. 38.

duplicative for ASIC to also require adequate resources or review risk management arrangements'.[28]

1.47 The committee notes that the government proposes in a forthcoming tranche of superannuation legislation to amend the Corporations Act so that RSE licensees that are also responsible entities of managed investment schemes would not be exempt from the Corporations Act requirements to have available adequate financial resources.[29]

Self managed superannuation funds

1.48 Many investors in Trio Capital did not invest as part of an APRA-regulated superannuation fund. Rather, they invested as a SMSF directly into the managed investment schemes for which Trio Capital was the responsible entity.

1.49 The Australian Taxation Office (ATO) defines 'self-managed superannuation fund' as a complying superannuation fund under the *Superannuation Industry (Supervision) Act 1993* that has:

- fewer than five members;
- each individual trustee of the fund is a fund member;
- each member of the fund is a trustee;
- no member of the fund is an employee of another member of a fund, unless those members are related; and
- if the trustee of the fund is a body corporate each director of the body corporate is a member of the fund.[30]

1.50 SMSFs are subject to less stringent regulatory requirements under the SIS Act than APRA-regulated funds. Trustees of SMSFs remain responsible for all decisions, and must make those decisions for the benefit of members, but SMSFs are not subject to the same prudential requirements as APRA-regulated funds. SMSF trustees are required to:

- make sure the sole purpose of the fund is to provide retirement benefits to the members;
- prepare and implement an investment strategy;

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28 ASIC, *Submission 51*, p. 96.

29 Draft Explanatory Memorandum, Superannuation Legislation Amendment (Further MySuper and transparency Measures) Bill 2012, p. 6. Hhttp://strongersuper.treasury.gov.au/content/exposure_drafts/super_legislation_amendment/downloads/Explanatory-Memorandum.pdfH (accessed 27 April 2012).

30 Australian Taxation Office, *Definitions*, Hhttp://www.ato.gov.au/corporate/content.aspx?menuid=6751&doc=/content/8153.htm&page=1#P995_83563H (accessed 28/07/2011).

- make investment decisions with respect to super and tax laws;
- accept contributions and pay benefits (pension or lump sums) in accordance with super and tax laws;
- ensure an approved auditor is appointed for each income year; and
- undertake administrative tasks such as lodging annual returns and record keeping.[31]

1.51 Reflecting this more limited regulatory regime, SMSFs are not regulated by APRA. Instead, they are registered with, and overseen by, the ATO. The ATO's focus is on the SMSF's compliance with superannuation and taxation laws, not on prudential safeguards. That is, the ATO focuses on ensuring that SMSFs are not used as vehicles to avoid tax, that the SMSF has an investment strategy and that an independent auditor verifies annually that its investments have been made in accordance with that strategy. Unlike APRA-regulated funds, the ATO's role as regulator is not to ensure that the SMSF has appropriate risk management strategies.

1.52 In its report, the Super System Review identified the reason for the regulatory focus on compliance, rather than prudential oversight as being because, in SMSFs, 'the trustees and members are one and the same people who have the incentive and responsibility to protect their own interests'. This alignment of interests is to be contrasted with the situation in an APRA-regulated fund. In such funds, the trustee is quite distinct from, and usually in a commercial relationship with, its members, and this requires more stringent safeguards to ensure that the interests of the trustee align with those of the members of the fund.

1.53 The close relationship between trustees and members of SMSFs has always been at the heart of the more relaxed prudential standards imposed on them, including when such funds were classed as "excluded funds" under the SIS Act and were subject to the oversight of APRA's predecessor, the Insurance and Superannuation Commissioner. Indeed, the 1997 Financial System Inquiry Final Report noted that while prudential regulation of the SMSF sector would be "impracticable", prudential and compliance standards could be improved by requiring the beneficiaries of SMSFs to be trustees of such funds.[32] This recommendation was implemented by the Superannuation Amendment Act (No.3) 1999 (Cth). It is important to note that this Act also moved responsibility for SMSFs from APRA to the ATO.

1.54 The lack of stringent prudential regulation of SMSFs means that the role of finance professionals is extremely important in both the decision to set up an SMSF, in developing its investment strategy, in implementing that strategy and in complying

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31 Australian Taxation Office, 'How your self-managed superannuation fund is regulated', Hhttp://www.ato.gov.au/content/downloads/spr00162377n71454.pdfH (accessed 10 May 2012).

32 S. Wallis, *Financial System Inquiry Final Report*, March 1997, pp 333–334.

with taxation laws and managing risk. Accountants' advice about the taxation implications and appropriateness of particular superannuation structures, such as SMSFs, and financial planners' advice about the investment strategies and risks of such funds will generally be central to people's decisions about the structure of their superannuation affairs. While an SMSF investor and trustee will use other finance professionals, such as auditors and actuaries, in their superannuation dealings, accountants and financial planners are generally people's entry point into the SMSF sector and, as such, occupy a key role in the sector.

Report structure

1.55 This report has nine chapters:

- Chapter 2 presents the structure and operation of Trio Capital, particularly the Astarra Strategic Fund and the ARP Growth Fund for which Trio was the responsible entity. The chapter concludes with a chronology of key events in the operation and collapse of Trio Capital.
- Chapter 3 acknowledges the impact that the collapse of Trio Capital has had on investors. It also examines compensation arrangements for Trio investors in APRA-regulated superannuation funds as opposed to self-managed superannuation funds.
- Chapter 4 presents the views of the regulators: APRA, ASIC, the ATO and the Treasury.
- Chapter 5 details the views of the gatekeepers: the internal auditor, KPMG; the external auditor, WHK; the custodians, ANZ Custodian Services and the National Australia Trustees Ltd; the research house Morningstar; the Financial Planning Association, the Financial Services Council and the Wollongong-based financial adviser Mr Ross Tarrant.
- Chapter 6 provides the views of Trio Capital investors, particularly SMSF investors in Trio. The chapter highlights their criticism of the regulators, the auditors, the research houses and financial advisers. It notes that many of these investors set up an SMSF and invested in Trio simply because their accountant or financial planner advised them to do so.
- Chapter 7 identifies seven 'expectations gaps'—differences between what investors perceive to be the role of a gatekeeper or the protections within the system and what is actually the case.
- Chapter 8 argues the case that there needs to be a much more vigorous criminal investigation, involving ASIC, APRA and the AFP into the Trio fraud. It emphasises that these investigations must be conducted with a view to pursuing the maximum available criminal sanctions against those responsible.
- Chapter 9 summarises the committee's findings and views.