

Chapter 8

The need for further investigations to recover funds and prosecute wrongdoing

Introduction

8.1 As noted in chapter 2, part of the complexity of the Trio structure and the frustration of investors and regulators in being unable to recover the funds lies in the alleged mastermind of the fraudulent conduct being based overseas. Mr Jack Flader, a Hong Kong based former US lawyer, has been identified by the Australian regulators as the controller of all the offshore Trio funds. In total, \$123 million in Australians' superannuation funds have not been able to be redeemed from Mr Flader's offshore funds.

8.2 In January 2011, it was reported that Mr Flader sold his business, Global Consultants and Services Ltd., to two Liechtenstein businessmen.¹ He is now, apparently, living in Thailand.²

8.3 The committee understands that Mr Flader has not broken any laws in Hong Kong. Further, the Australian Securities and Investments Commission (ASIC) has no jurisdiction in Hong Kong, although it has been reported that it has asked its counterpart in Hong Kong to interview Mr Flader.³

8.4 The committee emphasises that in the absence of a thorough investigation and prosecution, the allegations that Mr Flader was the lynchpin of the Trio fraud are only allegations. They remain unproven. That said, the committee does believe that considerably more can, and should, be done to track down the missing monies of Australian superannuation investors and investigate the role of Mr Flader and others.

Can ARP Growth Fund monies be recovered?

8.5 A key factual question before the committee is whether the principal underlying asset of the ARP Growth Fund—a derivative contract between British Virgin Islands company Professional Pensions ARP Ltd (PPARP) and the investment

1 Stuart Washington, 'Flader link to father and son in \$1 billion scam', *Sydney Morning Herald*, 25 January 2011, <http://www.smh.com.au/business/flader-link-to-father-and-son-in-1b-scam-20110124-1a2v0.html> (accessed 17 April 2012).

2 Tony Boyd, 'It's a joke , but no one's laughing', *Australian Financial Review*, 9 March 2012, p. 52.

3 Tony Boyd, 'It's a joke , but no one's laughing', *Australian Financial Review*, 9 March 2012, p. 52.

bank Bear Stearns—ever existed and had value. Was the contract and the underlying assets part of a fraud and if not, can the ARP Growth Fund monies be recovered?

8.6 the Australian Prudential Regulation Authority (APRA) gave evidence that it believed the contract did exist but its value fell to zero as a result of Bear Stearns' liquidation in the global financial crisis of 2008. In other words, it claimed that the money was lost as a result of a bad investment decision, rather than fraud:

One of the difficulties in this is that some of the investments were just bad investments. The Bear Stearns transaction, as far as we can see, was just a really bad investment at a bad time that had a bad result. I know that was not your point—your point was you were talking about the audit sign-off—but I think it is important that we look at the totality here. Yes, there was a significant fraud; but, yes, there were also some really shocking investments in retrospect.⁴

8.7 The committee also discussed with PPB Advisory the question of whether the funds were recoverable or whether the money was lost with the collapse of Bear Stearns. The administrators told the committee:

...when you look at the actual investments of the ARP Growth Fund, you will see they are purely units in a thing called PPARP, which is a company registered in the BVI. Technically, under the product disclosure statement, that is the investment. What PPARP decides to invest in from that point of time is purely at the discretion of PPARP. It was disclosed to the unit holders that PPARP had elected to invest in a derivative swap agreement with Bear Stearns. It was outlined to those investors that that agreement was done through two segregated portfolios, administered by a company called Empyrean. There was no disclosure in any of the documents as to what the underlying investments would be, because it was actually designed as a so-called synthetic platform, which means you do not actually make investments but you are investing in the hedge fund market. If the market goes up in total value, you receive a return on your investment. If it goes down, then there may be calls up by Bear Stearns in terms of the equity that they have provided.⁵

8.8 PPB Advisory told the committee that it was not yet able to conclude that the underlying assets held by the ARP Growth Fund were non-existent. It noted that it would conduct further inquiries into this matter which would require the cooperation of the regulators in the British Virgin Islands, among others. Mr Manwaring noted:

...there is an awful lot of different connected parties who we would need cooperation from. We understand that, in the background, there may be other reasons why parties that may be involved in the process are being looked at by other regulators, and ours may simply be the pimple of other

4 Mr Keith Chapman, ASIC, Executive General Manager, *Committee Hansard*, 30 August 2011, p. 39.

5 Mr Brett Manwaring, Director, Mr Mark Robinson, Partner PPB Advisory, *Committee Hansard*, 30 August 2011, pages 54–56.

things. So we certainly do not have all the information to be able to ascertain how we could ever find out the actual answers at this point.⁶

8.9 The committee also asked PPB Advisory whether the acquisition of Bear Stearns by JP Morgan could mean that it is possible to proceed against JP Morgan to recover the lost value. Mr Manwaring responded:

The party that is the counterparty to it, Empyreal, have stated that they have actually signed a settlement agreement with JP Morgan. We have never been provided a copy of that settlement agreement. We do know that the agreement itself was closed out. It was closed out in September 2008; that was the official date. Our understanding, based on the information we have received from both PPARP and Empyreal, is that an agreement was entered into between Empyreal and JP Morgan closing that agreement out, and a settlement was agreed to. We have never sighted that document. What is actually part of that settlement, we do not know.⁷

Committee view

8.10 The committee is not satisfied that APRA is correct in assuming that the PPARP–Bear Stearns contract did exist and that its value was wiped out with the liquidation of Bear Stearns in 2008. It is not clear to the committee that this view is based on a thorough investigation. Indeed, the committee is concerned that APRA holds this view because it has failed to fully investigate the alternative possibility: there may have never been a contract and the ARP Growth Fund was a fraudulent venture.

8.11 The committee believes there has not yet been a proper investigation into whether or not the ARP Growth Fund funds are recoverable. It is clearly an area that warrants further investigation. PPB Advisory has been funded by ASIC in phase 1 of its investigations into the collapse. In the committee's view, the phase 2 investigation also needs to be funded by ASIC. This should be done as a matter of urgency.

8.12 The committee heard that the cost of further investigation has been estimated at approximately \$180,000. This is not an unreasonable cost given the imperative of making all possible efforts to recover the funds of Australian investor who have been defrauded.

6 Mr Brett Manwaring, Director, Mr Mark Robinson, Partner PPB Advisory, *Committee Hansard*, 30 August 2011, pages 54-56.

7 Mr Brett Manwaring, Director, Mr Mark Robinson, Partner PPB Advisory, *Committee Hansard*, 30 August 2011, pages 54-56.

Recommendation 10

8.13 The committee recommends that the Australian Securities and Investments Commission provide all necessary funding for PPB Advisory to pursue its investigation to a full conclusion, including where necessary conducting examinations on oath of figures such as Mr Jack Flader and others it considers necessary as part of the investigation. The committee recommends that ASIC fund the phase 2 investigation by PPB Advisory as a matter of urgency.

The investigations of Australian crime-fighting agencies into Trio

8.14 The committee also has concerns that the various crime-fighting agencies should be doing more to seek to recover outstanding monies and bring to justice those who have committed crimes which have so badly affected Australian investors. There do not appear to be any criminal investigations into the conduct of Mr Flader or others involved in developing and implementing Trio's schemes.

The Australian Federal Police

8.15 The Australian Federal Police (AFP) has no current investigation into Trio. Indeed, Commander Peter Sykora, Manager of Crime Operations at the AFP, told the committee that the role of the federal police in investigating those involved with Trio overseas had been 'very minimal'. He explained:

The first thing we did with ASIC was to assist them in a number of search warrants here in Australia. They have the investigative lead and they have the investigators to handle the investigation under the Corporations Act 2001. So we were only called upon to act as a facilitator for those search warrants, and the documents that were seized with regard to a certain individual were then passed to them for further investigation. ASIC then obviously came to us to facilitate some international inquiries, which we did throughout our office. I also understand that another agency was involved in Hong Kong. They reached out to the AFP through the International Liaison Officer Network, and we put them in touch with ASIC. That was as far as our involvement was concerned in that case.⁸

8.16 The committee asked Commander Sykora his view on whether there is currently a need for further work on the Trio case. He responded:

I think the loss that has been seen throughout Trio is quite significant. But what we identified quite early on when ASIC approached us was that there was no Commonwealth broad per se for the AFP. This was a matter for ASIC to handle. However, in saying that, what we do see with a lot of our Commonwealth agencies here as well is that they can refer matters to us, particularly if they want to do it in a tripartite partnership—for want of a better term—with either the ACC or another government agency. We will

8 Commander Peter Sykora, Manager of Crime Operations, Australian Federal Police, *Committee Hansard*, 4 April 2012, p. 25.

then assess that referral as per our case categorisation and prioritisation model. Then we will either accept or not accept the job.⁹

8.17 The AFP noted that it currently has a senior liaison officer posted in Hong Kong, where Mr Flader resides. It also told the committee that it has the powers to recover assets which are deemed to be proceeds of crime. However, the AFP would not sell those assets and would therefore not be able to deliver the proceeds to the victims of crime.¹⁰

The Australian Crime Commission

8.18 The Australian Crime Commission (ACC) has not conducted any specific investigations into the Trio case. Mr John Lawler, Chief Executive Officer of the Commission, told the committee:

The ACC conducts special operations and investigations against Australia's highest threats from serious and organised crime. The ACC works with partners to disrupt, disable and dismantle serious and organised criminal syndicates. I need to say from the outset that the ACC has not undertaken any specific investigations into the activities of Trio Capital or the circumstances surrounding its collapse. However, the ACC has undertaken significant work on the issue of fraud, in particular international fraud, and can make a contribution to the committee, particularly against the inquiry's seventh, eighth and ninth terms of reference.¹¹

8.19 The committee queried why—when in excess of \$100 million of Australian investors' superannuation monies had gone missing and an auditor and five trustees had accepted some responsibility—the ACC had not looked into Trio. Mr Lawler responded:

Well, there are two reasons for that. One of the reasons goes to...the scope and breadth of the commission's work, which can be ascertained from the website—a very extensive scope around narcotics, child exploitation, money laundering and the list goes on. The second reason is that, at its heart, the commission does not want to duplicate anything anyone else can or is doing. So if there is an agency or agencies with responsibility for pursuing particular matters then our view is that they should pursue the matters. If, as the particular police jurisdiction in the context of Project Galilee, reach a situation where they say traditional methods of law enforcement investigation and approach are not sufficient, it is then under our legislation that the commission can be brought into play. So there is a set statutory response level required before the commission can be engaged.

9 Commander Peter Sykora, Manager of Crime Operations, Australian Federal Police, *Committee Hansard*, 4 April 2012, p. 25.

10 Commander Peter Sykora, Manager of Crime Operations, Australian Federal Police, *Committee Hansard*, 4 April 2012, p. 26.

11 Mr John Lawler, Chief Executive Officer, Australian Crime Commission, *Committee Hansard*, 4 April 2012, p. 19.

That is a judgment for the agencies tasked with this sort of investigation and the regulation of this sort of matter in the first instance. If, for example, they feel that the powers of the commission could aid such an investigation then they are quite at liberty to bring those forward to us.¹²

8.20 The committee is aware that the ACC Board, which includes Commissioners from every state/territory police jurisdiction and the heads of key Commonwealth agencies—has established Task Force Galilee. This Task Force seeks to disrupt serious and organised investment fraud operations and the organised criminal groups behind them. It also aims to educate the Australian community about this type of investment fraud and the threat it represents.¹³

AUSTRAC

8.21 AUSTRAC is Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regulator. It currently operates under section 209 of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act). AUSTRAC's role is to oversee compliance with the obligations of the AML/CTF Act and *Financial Transactions Report Act 1988* across various industry sectors. It collects and analyses financial information provided by regulated entities through financial transaction reports. This information is disseminated to Australian law enforcement, national security, human services and revenue agencies, as well as international counterparts, to assist in the investigation and prosecution of serious criminal activity including terrorism financing, organised crime and tax evasion.¹⁴

8.22 Significantly, it is the responsibility of gatekeepers, including auditors and custodians, to report suspicious matters to AUSTRAC. ANZ, the original custodian for Trio, noted that the AML CTF Act and the *Anti-Money Laundering and Counter-Terrorism Financing Rules 2007 (No. 1)* require participants in the financial services industry to make due diligence inquiries when taking on prospective clients, as well as carrying out suspicious matter reporting.¹⁵ It added:

The identification of suspicious matters is aided through transaction monitoring tools designed to detect abnormal or unusual behaviours based on certain typologies. ANZ provides guidance and training to staff to assist with the identification, and escalation, of suspicious matters.

Suspicious matters raised by ANZ staff are referred to a centralised ANZ team, ANZ Financial Intelligence Office (FIO), for further investigation. FIO acts as the escalation point to ensure that any suspicious matters sent to

12 Mr John Lawler, Chief Executive Officer, Australian Crime Commission, *Committee Hansard*, 4 April 2012, pp 22–23.

13 Australian Crime Commission, 'Serious and organised fraudulent investment scams', <http://www.crimecommission.gov.au/publications/crime-profile-series-fact-sheet/serious-and-organised-fraudulent-investment-scams> (accessed 11 May 2012).

14 AUSTRAC, *Annual Report 2010–2011*, Agency overview, p. 1.

15 ANZ, *Submission 70*, p. 8.

AUSTRAC contain complete and relevant information to assist in the broader management of financial crime. ANZ officers within FIO investigate each ‘suspicious and unusual activity matter report’ in order to determine whether a suspicious matter report should be provided to AUSTRAC as required under the AML CTF Act. For example, ANZ in the year to 30 September 2011 reported 1092 suspicious matters to AUSTRAC.¹⁶

8.23 The committee did not receive a submission, or take direct evidence from AUSTRAC. It does appear, however, that AUSTRAC was not given any significant information from the various gatekeepers alerting it to suspicious activity in Trio Capital. In this context, questions must be raised as to whether the gatekeepers—particularly the financial advisers and custodians—conducted due diligence when taking on prospective clients.

Committee view

8.24 The committee questions why one of the largest financial frauds in Australian history has not been more thoroughly investigated by agencies such as the AFP and the ACC. Chapter 5 noted that various gatekeepers pointed to others' responsibilities rather than their own. The evidence above similarly indicates that Australia's crime fighting agencies seem to have deferred responsibility to other agencies: the AFP to ASIC, and the ACC to the AFP among others. Notwithstanding the progress that the AFP, the ACC and AUSTRAC have made in coordinating their detection and response to international financial fraud, in the case of Trio and Mr Flader, there do not seem to have been satisfactory investigations.

8.25 The committee asks whether any attempts have been made to bring charges against Mr Flader and others, to have them extradited to Australia, or even as to whether their names are on a watch list for people passing through Australian airports. The committee believes that, unless there is compelling evidence that these efforts would be futile, there should be concerted action on these matters. Of course, ASIC and APRA have a crucial role to support and coordinate these investigations.

Recommendation 11

8.26 The committee recommends that the Australian Federal Police, in cooperation with the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority, pursue criminal investigations into—and, where applicable, criminal sanctions against—the key figures responsible for defrauding investors in Trio as a matter of high priority.

16 ANZ, *Submission 70*, pp 9–10.

Is Australian superannuation an easy target?

8.27 Australia boasts the fourth largest funds management market in the world. One consultancy has estimated that in June 2011, 44.8 per cent of the \$1.3 trillion in funds under investment managers were in the form of superannuation savings. It anticipated that in 2011–2012, the superannuation funds management industry would generate revenue of \$9.42 billion from an estimated \$532 billion in superannuation assets for which they provide investment services.¹⁷ These figures are likely to increase over time, particularly given the imminent increase in the Superannuation Guarantee Charge from 9 to 12 per cent.

8.28 While this is good news for both superannuants and the funds management industry, there is some belief that the size of the funds invested in Australian superannuation makes it a target for fraud. Media clichés like 'honey pot' are increasingly used to describe the amassed superannuation funds.¹⁸ In the case of Trio, the fraud specifically and principally targeted superannuation savings, and appears to be designed to take advantage of vulnerabilities in the superannuation system.

8.29 The committee notes that Task Force Galilee was established partly in response to the threat that organised crime posed to Australia's superannuation savings, and that these savings are an attractive target for criminals. An ACC publication on Task Force Galilee stated:

Organised criminal groups are attracted to the high levels of superannuation and retirement savings in Australia. The Australian economy is known to have been less affected by the global financial crisis than other nations, making those approaching retirement, an attractive target. In the next 20 years, a large number of Australians are expected to retire from active work and will have superannuation investments to manage. Raising awareness of fraudulent serious and organised investment scams is important in preventing people falling victim.¹⁹

8.30 The committee received little evidence during this inquiry on the extent to which the Australian superannuation system is vulnerable to sophisticated attempts to defraud this system and its investors. The Australian Custodial Services Association noted that 'the financial services industry is particularly vulnerable to the risk of international fraud'²⁰. However, the Financial Services Council (FSC) took the

17 IBISWorld, 'Superannuation Funds Management in Australia: A research report', April 2012, <http://www.ibisworld.com.au/industry/default.aspx?indid=1890> (accessed 17 April 2012).

18 'Australian seniors warned of fraudsters increasingly targeting their \$1.3 trillion superannuation', *Courier Mail*, 28 August 2011, <http://www.couriermail.com.au/money/australian-seniors-warned-of-fraudsters-increasingly-targeting-their-13-trillion-superannuation/story-e6freqp6-1226123542266> (accessed 27 October 2011)

19 Australian Crime Commission, 'Serious and organised fraudulent investment schemes', *Fact sheet*.

20 ACSA, *Submission 43*, p. 3.

opposite view. Asked whether the size of Australia's funds industry and the large pool of capital relative to population size made Australia a target for international fraudsters, the FSC replied:

No. The Australian market internationally is regarded as being highly regulated and so it is probably the opposite to that. Notwithstanding we have the fourth largest pool of fund management assets globally, the fact that it is so heavily regulated, obviously relative to other markets, means that it is not seen as the destination of choice.²¹

8.31 In a similar vein, APRA argued that 'cases of fraud in the regulated superannuation sector are rare'²², accepting perhaps that it is inevitable some people will always be tempted to defraud others no matter what regulatory boundaries are in place. Chapter 4 of this report noted APRA and ASIC's view that even the best regulatory system will be unable to detect and intercept all fraud. While this may be true, the committee emphasises that several things can and should be done to guard against a repeat of Trio.

Committee view

8.32 In the committee's opinion, the Trio case exposes the significant vulnerability of the Australian superannuation savings system to targeting by criminals, including offshore based criminals. The committee believes that several factors have contributed to making the system attractive to these criminal elements.

8.33 First, and most obviously, Australia does have a very large pool of superannuation savings. Second, many Australians are disengaged from their superannuation savings. This is a product of a compulsory superannuation system, of many younger people having low balances, and of investors' inability to access their funds until they retire. The result is that many people will not pay close attention to how their funds are performing. There is far less occasion for most people to check a superannuation account balance than there is to check their bank account balance. Detecting a fraud against a bank account is therefore more likely than it is against a superannuation account. In the case of Trio, Mr Paul Gresham produced fictitious account statements for several years. Account holders had no reason to seek to withdraw the money and as a result, the fraud continued undiscovered for some time.

8.34 In this context, the committee draws attention to a 2005 speech by Mr Jeremy Cooper, then Deputy Chairman of ASIC, in which he outlined the risks posed by fraudulent financial statements and steps that had been taken in the US to address this problem.²³ Mr Cooper stated:

21 Mr Martin Codina, Policy Director, Financial Services Council, *Committee Hansard*, 30 August 2011, p. 30.

22 APRA, *Submission 41*, p. 8.

23 Mr Jeremy Cooper, Deputy Chair, ASIC, speech entitled *Financial Statement Fraud: Corporate Crime of the 21st Century*, 8 June 2005

One of the key US initiatives aimed at combating financial statement fraud was the requirement for internal controls mandated by section 404 of the Sarbanes-Oxley Act. This feature was not adopted in Australia and this remains one of the key points of difference between our two systems. There are some aspects of the quality review concept in AUS 206 [an auditing standard], but the key theme of 404, relating to the testing of internal controls, has no Australian equivalent.²⁴

8.35 The committee believes there are significant policy steps required to better protect against the threat to the superannuation system from criminals. These include:

- (a) the establishment of a dedicated superannuation fraud squad in the AFP;
- (b) more detailed scrutiny by APRA of the 'trigger points' at which criminals take control of superannuation vehicles. In the case of Trio, the most obvious 'trigger points' were the acquisition of Tolhurst by the Trio directors and the decision by the Professional Pensions Pooled Superannuation Trust (PPPST) to remove the Trust Company as a trustee (see chapter 2);
- (c) a much more vigorous criminal investigation, involving ASIC, APRA and the AFP, into the Trio fraud, with a view to pursuing the maximum available criminal sanctions against those responsible. This will send the message to others considering targeting the superannuation sector that they face significant consequences from doing so; and
- (d) legislation to allow assets to be recovered from those personally involved in fraud and theft, with the proceeds to go towards compensating those who have lost money as a result of the fraud and theft.

24 Mr Jeremy Cooper, Deputy Chair, ASIC, speech entitled *Financial Statement Fraud: Corporate Crime of the 21st Century*, 8 June 2005, p. 14.

Recommendation 12

8.36 The committee recommends that the government investigate the options for a scheme to recover assets from those found to be personally involved in fraud and theft, with the proceeds to go to those found to have been defrauded.

Recommendation 13

8.37 The committee recommends that the Australian Prudential Regulation Authority conduct an internal assessment of the adequacy and timeliness of its checks to monitor the ownership of superannuation vehicles. This process must review why key 'trigger points' in events that led to the collapse of Trio Capital were not identified.

Recommendation 14

8.38 The committee recommends that the Australian Federal Police consider the options to create an organisational focus on the matters pertaining to superannuation fraud. This should occur in close consultation with the Australian Crime Commission given its work in coordinating Task Force Galilee.

